No. 10,085

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GLADYS M. SHORES and HAROLD M. F. BEHNEMAN,

Appellants,

vs.

HENDY REALIZATION CO., a corporation (formerly the Joshua Hendy Iron Works), A. J. MAYMAN, C. B. MOORES, E. PRICE, A. E. WEBBER and W. R. BASSICK, individually and as the Directors of Hendy Realization Co., ELMER M. HYLAND and MORRIS LEVIT,

Appellees.

BRIEF FOR APPELLEES.

MARSHALL P. MADISON,

FRANCIS R. KIRKHAM,

GERALD S. LEVIN,

Standard Oil Building, San Francisco, California,

STANLEY PEDDER,

KENNETH FERGUSON,

Financial Center Building, San Francisco, California,

PERCY V. LONG,

BERT W. LEVIT,

WILLIAM H. LEVIT,

Merchants Exchange Building, San Francisco, California,

Attorneys for Appellees.

PILLSBURY, MADISON & SUTRO,

Standard Oil Building, San Francisco, California,

LONG & LEVIT,

Merchants Exchange Building, San Francisco, California,

Of Counsel.

Table of Contents

Table of Authorities Cited

Cases

Statutes and Codes

Encyclopedias and Textbooks

No. 10,085

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GLADYS M. SHORES and HAROLD M. F. BEHNEMAN,

Appellants,

vs.

HENDY REALIZATION CO., a corporation (formerly the Joshua Hendy Iron Works), A. J. MAYMAN, C. B. MOORES, E. PRICE, A. E. WEBBER and W. R. BASSICK, individually and as the Directors of Hendy Realization Co., ELMER M. HYLAND and MORRIS LEVIT,

Appellees.

BRIEF FOR APPELLEES.

These consolidated causes involve two questions—first, the jurisdiction of the district court, and, second, whether or not the judgment of the district court is correct upon the merits. No attack was made upon the merits of the judgment until the question of the contents of the record was brought before this court. But, despite the fact that appellants' attack upon the merits is an afterthought, its inclusion in appellants' brief necessitates a full consideration of the facts.

Appellants' purported statement of facts in the "Jurisdictional Statement"[1] does not give the facts of the case.

It consists mainly of a recapitulation of the allegations in a number of appellants' pleadings which are of no significance upon this appeal. Accordingly it is necessary for us to state the facts.

Because of the volume of the record, a detailed statement of the whole of the evidence is, of course, impracticable; but the salient features are chronologically summarized in the following statement.

STATEMENT OF FACTS.

Appellee Hendy Realization Co., a California corporation (formerly and until 1940 The Joshua Hendy Iron Works), was incorporated in 1906[2] and, until the sale of its plant in 1940, continuously engaged in a general machinery and foundry business, with its plant at Sunnyvale, California.[3]

Although the company continuously engaged in business, it never paid a dividend upon its stock;[4] and in 1932 the company was thrown into an equity receivership in the state court.[5] In the receivership proceedings F. J. Behneman (the father of appellant Harold M. F. Behneman), who had for many years been the president and general manager of the company, was appointed receiver. F. J. Behneman died in 1934, and appellee W. R. Bassick was appointed his successor.[6]

---

[1]Appellants' Brief p. 1 et seq.
[2]Tr. p. 175.
[3]Tr. p. 533.
[4]Tr. p. 573.
[5]Tr. pp. 175, 203.
[6]Tr. p. 417.

On March 4, 1935, and while the state receivership was still pending, an involuntary petition was filed in the district court by the major creditors of the corporation and proceedings were taken for its reorganization pursuant to Sections 77A and 77B of the Bankruptcy Act.[7] Appellee W. R. Bassick was appointed trustee for the company and actively managed its business.[8] This bankruptcy proceeding is one of the two consolidated causes now before this court.

As the result of this proceeding a plan of reorganization was duly adopted and confirmed by the district court on March 24, 1936.[9] Both appellants, who had become stockholders by virtue of having received their stock from their parents, appeared as stockholders at the hearings upon the plan—appellant Gladys M. Shores to accept and approve the plan in writing under oath,[10] and appellant Harold M. F. Behneman as the only stockholder to oppose the plan.[11]

At the time that the plan of reorganization was confirmed the district court and the parties were confronted with a debtor corporation which, under the long management of F. J. Behneman, appellant Behneman's father, had so managed its affairs that:

(1) In twenty months' operations the corporation had lost $183,000.00;[12]

(2) The physical assets of the corporation had been so wasted that:

---

[7]Tr. p. 203.
[8]Tr. p. 204.
[9]Tr. p. 201.
[10]Tr. p. 200.
[11]Tr. pp. 169, 154.
[12]Resp. Ex. No. B; Plff. Ex. No. 3A.

> "In 1934 the plant was in a deplorable condition. In fact, when Mr. Bassick took charge there was not a man working on any profitable job in the organization. It was simply flat. That was the condition when he came to the plant for the first time, all of the tools, when I say 'all of the tools,' I should say practically all of the tools were so run down that they were not capable of producing any work with sufficiently close tolerances to meet the customers' requirements. From 1934 until 1936 some progress was made toward rebuilding those tools and fixing them up, but there was very little money available, therefore not much progress was made.";[13]

(3) The books of the corporation did not reflect actual values or conditions; as, for example, "there had been no consistent depreciation period, that in some years no deductions were made for depreciation, some years round sums were deducted, and still other years odd amounts which could not be substantiated."[14] The books were, in fact, so unreliable that the special master in the reorganization proceedings recommended and procured the appointment of an independent valuation engineer to report upon actual values and conditions;[15]

(4) The corporation had outstanding obligations of $644,732.27, plus accrued interest thereon;[16] and

(5) The corporation was insolvent and its stock was worthless. This the special master and the district court expressly found and held,[17] and this appellants now con-

---

[13]Tr. p. 724.
[14]Tr. pp. 869, 435-7, 798-801, 690-695.
[15]Tr. pp. 467, 470-3, 475-9.
[16]Tr. p. 531.
[17]Tr. pp. 159-166, 201, 697-8.

cede,[18] and in the reorganization proceedings conceded,[19] although they vigorously contended otherwise during the trial.[20]

Since the corporation was insolvent, the plan of reorganization first provided that all of the corporation's creditors should scale down their obligations either 10% or 15%, depending upon whether such obligations were secured or unsecured—a total reduction of $76,401.00—and receive long-term notes for such reduced obligations bearing a substantially smaller rate of interest, and in certain instances no interest.[21] This was done, and pursuant to the plan of reorganization the creditors gave up a substantial part of their claims and slashed the interest on the remaining balance.

Since the stock of the corporation was worthless, the plan of reorganization provided, among other things:[22]

> "G. Capital stock.
>
> 4425 shares of the capital stock of the debtor corporation are now outstanding, said shares having a book value of $212,898.51, but no actual value.
>
> In consideration of the extensions granted by the creditors and of the reduction of their claims in the sum of $73,853.06, as aforesaid, the stockholders shall appropriately endorse and deliver the stock held by them to the Board of Directors of the debtor corporation, appointed as hereinafter provided, to be held by said Board as follows:
>
> 1. 50% of the shares so deposited by each stockholder shall be held in trust and voted by said

[18]Appellants' Brief p. 55.
[19]Tr. pp. 462, 696-7.
[20]Tr. pp. 655-6.
[21]Tr. pp. 181-6.
[22]Tr. pp. 186-7.

Board for a period of 5 years, and thereafter until the extended obligations are fully paid, so as to leave the management of the debtor corporation during such period in the hands of its creditors. The Board shall have full power to vote said stock, including the power to vote for a reorganization of the capital structure of the debtor corporation so as to provide, at any time, for an issue of one or more classes of preferred stock and the exchange therefor of any part or all of the unsecured liabilities of the debtor corporation. Upon the expiration of 5 years and the payment in full of the extended obligations, such shares shall be returned to their respective owners.

2. The remaining 50% of the shares so delivered by each stockholder shall be held by said Board free and clear of any claim, right, title, or interest therein by such stockholder, to be distributed by said Board, in its sole discretion, either in whole or in part, to the managing officers thereof, as a reward for management and the successful rehabilitation of the company's affairs."

Pursuant to the terms of the order dated March 24, 1936, confirming the plan of reorganization, all of the then stockholders of the corporation, with the exception of appellant Harold M. F. Behneman, endorsed and delivered their stock to the directors of the corporation who thereafter held it as trustees pursuant to the terms of the confirmed plan of reorganization; and the depositing stockholders executed a confirming trustees' receipt and certificate with the board of directors as voting trustees, so that the stock deposited by each of them was held by such trustees 50% in trust for such depositing stockholders and 50% free and clear of any claim, right,

title, or interest therein by such stockholders as provided by, and for the purposes provided by, the plan of reorganization.[23] Appellant Harold M. F. Behneman refused similarly to endorse and deliver his stock, standing in his father's name, until June, 1940.[24]

On January 27, 1937, the district court made its "Final Decree, etc." in the reorganization proceedings, to which decree reference will hereafter be made.[25]

Immediately following the confirmation of its plan of reorganization, the corporation, through its individual directors, made arrangements with appellees W. R. Bassick, Elmer M. Hyland, and Morris Levit, its president and vice presidents in charge of sales and manufacturing, by which each agreed to scale down and take, for the time being, less than the compensation to which each was entitled. These arrangements were made upon the express understanding that such concession was being temporarily made so as to assist in the rehabilitation of the corporation's affairs, and that as soon as the affairs of the corporation warranted, this partial compensation would be supplemented by cash bonuses or distributions and by the distribution of the capital stock of the corporation held by the board of directors as voting trustees.[26]

Appellees Bassick, Hyland, and Levit accordingly served as the managing president and vice presidents of the corporation from that time and until November 15, 1940,[27] receiving only partial compensation for their services in

---

[23]Tr. pp. 756-757, 544.
[24]Tr. pp. 544, 681.
[25]Tr. p. 225.
[26]Tr. pp. 740-752, 761-790, 815-845, 716-724, 727-735, 704-716, 613-622, 610, and Resp. Ex. Nos. A, E, E-1, E-2, E-3, E-4, E-5.
[27]Tr. pp. 576, 580, 594, 541-2.

accordance with such arrangement. It is true that during this period there were minor adjustments made on account of their salaries, and minor bonuses paid, but the evidence is uncontradicted that it was understood that these payments were only on account of their partial compensation, and that there were, during these years, many conferences between the managing officers and the directors regarding the officers' compensation, in the course of all of which conversations the understanding was confirmed that such officers would ultimately be paid, by distribution of cash and the stock held by the voting trustees, for the balance due them on account of the services rendered by them throughout these years.[28]

The business and affairs of the corporation under the direction of its new board of directors, and under the management of its new president, appellee Bassick, and its vice presidents, appellees Levit and Hyland, steadily improved.[29] For example:

(1) The corporation had, between June 30, 1936, and November 15, 1940, a net profit before depreciation of approximately $350,000.00, and had a net income after adequate depreciation and interest deductions of almost $200,000.00.[30] This may be compared with the $183,000.00 lost by the corporation in the twenty months preceding its reorganization;[31]

(2) Not only had the corporation paid all interest upon its receivership obligations, but it had paid off

---

[28]Tr. pp. 740-752, 761-790, 815-845, 716-724, 727-735, 704-716, 613-622, 610.

[29]Its comparative balance sheets are in evidence; Plff. Ex. Nos. 3, 3A, 3B, 3C, 3D, 3E, 3F; Resp. Ex. Nos. B, C; and summaries therefrom, Resp. Ex. Nos. F, G, H, I.

[30]Resp. Ex. Nos. H, F; Tr. pp. 801-6, 849.

[31]Resp. Ex. No. B; Plff. Ex. No. 3A.

more than 50% of these obligations, without refinancing—a payment of more than $300,000.00;[32]

(3) The net worth of the corporation had risen from a **minus**[33] $61,787.36 in 1936 to a net worth of $206,330.87 at the beginning of November, 1940. In other words, the outstanding stock of the corporation which was **absolutely worthless** at the time of its reorganization, had, by dint of appellees' management, become worth $206,330.87;[34]

(4) And in addition to all this, and out of operating revenues, and not capital investment, the physical plant of the corporation had been brought back. After testifying to the "deplorable condition" of the plant with which the new management was presented, the plant superintendent testified:[35]

> "When the reorganization plan became effective in 1936 we really started in then to overhaul the plant and tools, as well as the building, and I think I can safely say that 90 per cent. of the machine tools in that plant were overhauled and the expense charged as an operating expense of the plant, and also the buildings were in such shape that they were really unsafe for the overhead electrical cranes to travel in the building, and necessitated reenforcing the building as well as the foundation, all of which expense was absorbed as operating expense of the plant."

This, then, was the situation in November, 1940, when the corporation was approached by Mr. Felix Kahn, of MacDonald & Kahn, with a proposal to purchase the

---

[32]Resp. Ex. Nos. I, G; Tr. pp. 805-8, 849.
[33]Emphasis ours throughout this brief unless otherwise stated.
[34]Resp. Ex. Nos. H, F; Tr. pp. 801-6, 849.
[35]Tr. p. 725.

Sunnyvale plant of the corporation.[36] The board of directors of the corporation was then, and throughout the remaining transactions, comprised of appellees C. B. Moores, A. J. Mayman, and W. R. Bassick, nominated by the secured creditors; appellee E. Price, nominated by the unsecured creditors; and appellee A. E. Webber, nominated by the old stockholders. On November 4, 1940, after a meeting of the board of directors, the corporation granted an option to Felix Kahn, trustee, for $10,000.00, to purchase the Sunnyvale plant of the corporation for the sum of $426,000.00 cash, subject to the usual adjustments for inventory, work in progress, etc.[37]

On November 13, 1940, the corporation notified all of its stockholders, including appellants, that it had granted such option, and that it proposed to sell the Sunnyvale plant and property. No objection to such sale was received.[38]

On November 15, 1940, MacDonald & Kahn, the assignee of Felix Kahn, trustee, exercised the option and paid the balance of the purchase price of $426,000.00.[39] On the same date, meetings were held by the corporation's stockholders, its board of directors, and its voting trustees holding its stock pursuant to the plan of reorganization, at which meetings the sale of the Sunnyvale plant and property was approved and confirmed.[40] Although notice of such intended action had been mailed to all stockholders, no protest or objection was made by either of appellants.[41]

---

[36]Tr. pp. 595-6.
[37]Tr. pp. 597, 603.
[38]Tr. pp. 866-7, 809, 811.
[39]Tr. pp. 533, 547-9, 812.
[40]Tr. p. 548; Plff. Ex. No. 6.
[41]Tr. pp. 866-7, 811.

The profit to the corporation on the sale of its Sunnyvale plant was approximately $131,000.00;[42] and the realization of such profit increased the net worth of the company, and of its originally valueless stock, to $335,825.33.[43]

On November 19, 1940, the corporation, in accordance with the terms of sale, by meetings of its directors and stockholders, authorized the change of its name from The Joshua Hendy Iron Works to Hendy Realization Co.[44]

On December 2, 1940, and December 4, 1940, the corporation's board of directors, taking an intervening adjournment, considered at length the payment of proper compensation to the officers and employees of the corporation,[45] and as a result authorized the distribution of an aggregate of $102,100.00 to twenty-two of its officers and employees.[46] This distribution was made and, pursuant to their understanding and arrangement with the corporation, the managing president and vice presidents of the corporation participated therein to the following extent:

Appellee W. R. Bassick	$40,000.00,
Appellee Elmer M. Hyland	20,000.00,
Appellee Morris Levit	20,000.00.

The major considerations actuating this cash distribution by the board of directors were partially summarized in the minutes of the meetings of December 2, and December 4, 1940, as follows:

---

[42]Tr. p. 860.
[43]Resp. Ex. Nos. H, F; Tr. pp. 801-6, 849.
[44]Tr. p. 530.
[45]Tr. pp. 815-817, 553-557.
[46]Including two employees added at a directors' meeting held December 20, 1940; Tr. p. 557.

December 2, 1940:[47]

"Director C. B. Moores then called the following facts to the attention of the Board of Directors:

(1) That certain of the officers and employees of the corporation have, since its reorganization, rendered extremely valuable services to the corporation resulting in its rehabilitation as a sound and going business, and the improvement of the financial condition of the company from a point where the stockholders of the company had little or no equity as evidenced by the records of the reorganization of the corporation under Section 77B of the Bankruptcy Act, to a point where the equity of the stockholders has become very substantial;

(2) That it was this rehabilitation of the corporation's business, so occasioned, which made possible the advantageous sale of the Sunnyvale plant and properties of the corporation, just consummated;

(3) That notwithstanding the value of such services to the corporation, the compensation of such officers and employees has not been commensurate therewith; and that the board, through its directors, has repeatedly represented to such officers and employees that the compensation received by them during said period would be supplemented by additional payment therefor as soon as in the opinion of the board such further payment was practicable and expedient;

(4) That, in addition, due to the sale of the corporation's Sunnyvale plant and properties, the employment of said officers and employees has necessarily been abruptly severed and their vacation and other rights interfered with;

---

[47]Tr. pp. 815-817.

And he suggested that, since the affairs and position of the corporation now warranted the board's action in such connection, the board consider the proper payment and reward of such officers and employees on account of their said services and in relation to their respective contributions to the restoration of the corporation. This being the consensus of the meeting, an extended and detailed discussion upon the matter was thereupon had, all directors participating, in an effort to work out a definitive plan for such payment commensurate with the best interests of the corporation and the fair and proportionate payment and reward of such officers and employees. Various tentative proposals in this regard were made and considered, and thereupon, and upon motion duly made, seconded, and unanimously carried, the meeting was duly adjourned to Wednesday, December 4, 1940, at eleven o'clock, A. M., in order that the directors should have an opportunity to further consider and weigh said proposals prior to, and so as to enable, matured and final action thereupon."

December 4, 1940:[48]

"The President stated that the first business of the meeting was the consideration of Mr. Moores' suggestion under advisement at the previous meeting, and the various proposals presented at the meeting of the Board of Directors on December 2, 1940, relative to the compensation of certain of the officers and employees of the corporation. Further discussion upon the matter was thereupon had, at the conclusion of which it was moved by Director C. B. Moores, seconded by Director A. Webber, and unanimously carried—Director W. R. Bassick, however, expressly not participating in said vote—that the following

[48]Tr. pp. 553-7.

resolution be adopted (expressly, however, without prejudice to the right of the Board, acting as Voting Trustees pursuant to the confirmed plan of reorganization of the corporation, to further reward the managing officers of the corporation for their services by the distribution of capital stock of the corporation as provided, inter alia, in Paragraph G-2 of said plan of reorganization):

'Whereas, the financial position, business, and affairs of this corporation have, since its reorganization, evidenced steady and substantial improvement to the point that they have become sound, businesslike, and satisfactory in condition; and

Whereas, the achievement of this fact has been made possible only by the unselfish and unremitting efforts and diligence of certain of its officers and employees since its reorganization; and

Whereas, throughout this entire period, this corporation has not paid such officers and employees for their services in accordance with the full value thereof to this corporation, but said officers and employees have been paid therefor and have accepted substantially less than the value of their said services to this corporation in consideration of the fact, and upon the representation of this Board of Directors, that a further payment, which with the amount already paid, would constitute a fair payment therefor, would be made at a later but the earliest expedient date; and

Whereas, the affairs and position of this corporation are now such that said officers and employees can be paid for their said services, and it is fair and just that said officers and employees should be rewarded for their said services and paid therefor, and for the severance of their employment and interference with their vacation and

other rights occasioned by the sale of the Sunnyvale plant and properties of this corporation; and

Whereas, it appears to be for the best interests of this corporation that the following resolution be adopted:

Now therefore, be it resolved, that this corporation forthwith pay the following amounts to the following of the officers and employees of this corporation in recognition, appreciation, payment, and reward for their exemplary and valuable services to this corporation:

W. R. Bassick	$40,000.00
E. M. Hyland	20,000.00
M. Levit	20,000.00
C. B. McAulay	10,000.00
C. E. Birkenbeul	3,000.00
J. M. Brown	3,000.00
J. L. Whitehead	1,000.00
R. N. Parkin	1,000.00
Frank L. McAdam	500.00
Margaret Terry	500.00
C. Cortage	500.00
A. R. Sillers	500.00
W. C. Theller	500.00
R. M. Spedding	500.00
L. A. Wall	100.00
Grace Miguelgorry	100.00
Juliette del Castillo	100.00
Ruth Barbier	100.00
Gerda Mangels	100.00
Thelma Broeder	100.00

And be it further resolved, that the officers of this corporation be and they are hereby authorized and directed to take such steps and to make such payments as shall be necessary or desirable to effectuate and carry this resolution into effect.' "

While these were the chief considerations, testimony as to additional considerations appear throughout the record; as, for example, that the corporation had ceased business and was contemplating dissolution; and that if each of those employees who might be entitled to receive stock in the opinion of the board were to have stock distributed to him it would require rather involved complications and would necessitate, after he received stock, his participation in liquidating dividends, so that the board determined to adjust the compensation to approximately the amount which such employee would have received as liquidating dividends on the stock.[49] Throughout the entire record, however, there is repeated testimony that this cash distribution was, particularly in the case of its managing officers, a supplemental and partial compensation for the underpaid services of those officers rendered pursuant to their understanding and arrangement with the corporation.[50]

On December 20, 1940, the board of directors of the corporation authorized and distributed the 2212½ shares of stock held by them, as voting trustees, for the reward of management pursuant to the terms of the plan of reorganization. The resolution authorizing this distribution of stock, and the consideration of the board of directors in so resolving were stated in its minutes as follows:[51]

> "Upon motion duly made, seconded, and unanimously carried, Director W. R. Bassick, however,

---

[49]Tr. pp. 818-9.

[50]Tr. pp. 740-752, 761-790, 815-845, 716-724, 727-735, 704-716, 613-622, 610, and Resp. Ex. Nos. A, E, E-1, E-2, E-3, E-4, and E-5.

[51]Tr. pp. 564-8.

expressly not participating in the vote, the following resolution was adopted:

'Whereas, under the terms of the confirmed plan of reorganization of this corporation and the Voting Trust created pursuant thereto, 2212½ shares of the capital stock of this corporation are now held by this Board, as Voting Trustees, free and clear of any claim, right, title, or interest therein by the former stockholders surrendering the same, and subject to the distribution by this Board, in its sole discretion, either in whole or in part to the managing officers of this corporation as a reward for their management and the successful rehabilitation of the corporation's affairs; and

Whereas, the officers of this corporation hereinafter named have, since its reorganization, rendered extremely valuable services to, and in the management of, the corporation, resulting in its rehabilitation as a sound and going business, and the improvement of the financial condition of the corporation from a point where the stockholders of the corporation had no equity, as evidenced by the records of the reorganization of the corporation under Section 77B of the Bankruptcy Act, to a point where the equity of the stockholders has become very substantial; and

Whereas, the financial position, business, and affairs of this corporation have, since its reorganization, evidenced steady and substantial improvement to the point that they have become rehabilitated, sound, business-like, and satisfactory in condition, and such rehabilitation of the corporation's business so occasioned has made possible the advantageous sale of the Sunnyvale plant and properties of the corporation just consummated; and

Whereas, notwithstanding the value of such services to this corporation, the compensation of such officers has not been commensurate therewith, and this Board, through its Directors, has repeatedly represented to such officers that the compensation received by them during said period would be supplemented by additional reward as soon as in the opinion of the Board such further reward was practical and expedient; and

Whereas, in addition, due to the sale of the corporation's Sunnyvale plant and the properties, the employment of certain of said officers has necessarily been severed, and their vacation and other rights interfered with; and

Whereas, it appears just and proper that said 2212½ shares of the capital stock of this corporation held by this Board, as aforesaid, be issued to said managing officers, subject to the condition hereinafter set forth, as a reward for their successful management and rehabilitation of the corporation's affairs; and it appears to be for the best interests of this corporation that the following resolution be adopted;

Now therefore, be it resolved, that this Board forthwith distribute said 2212½ shares of the capital stock of this corporation so held by it to the following persons in the respective amounts hereinafter set forth, in recognition, appreciation, payment, and the reward for their exemplary and valuable services to this corporation and as a reward for their management and the successful rehabilitation of the corporation's affairs:

W. R. BASSICK	812½ shares
E. M. HYLAND	700 shares
M. LEVIT	700 shares;

provided, however, that each such person shall, prior to, and as a condition precedent to, receiving such distribution of stock, waive in writing the right of such person to receive any dividends or distribution upon said stock out of the first $85,-848.75 available for dividends or distribution upon the capital stock of this corporation, in dissolution or otherwise, so that the said sum of $85,848.75 may be prorated and paid by way of dividend, distribution, or otherwise (or set aside for such payment), only to the holders of the remaining 1907¾ shares of the outstanding stock of the corporation now held by this Board as Voting Trustees, to the end that said persons holding said 2212½ shares hereby distributed shall only participate in dividends or distributions upon the capital stock of this corporation made in excess of said sum of $85,848.75, as aforesaid.

And be it further resolved, that the President or Vice-President and the Secretary or Assistant Secretary of this corporation be and they are hereby authorized and directed, for and on behalf of this Board, to take all such steps and to execute all such documents as may be necessary or desirable to effectuate the distribution, transfer, and delivery of said stock to said officers, as aforesaid, and to fully effectuate the purposes of this resolution.' ''

Pursuant to this resolution the board of directors, as voting trustees, on December 20, 1940, distributed 812½ shares of stock to appellee W. R. Bassick, the corporation's president and general manager, 700 shares to appellee Elmer M. Hyland, the corporation's vice president in charge of manufacturing, and 700 shares to appellee Morris Levit, the corporation's vice president in charge of sales; first receiving, however, waivers executed by

each of these officers waiving his right to receive liquidating dividends on the stock to the extent of the first $85,848.75 available for dividends—that is to say, waiving his right to participate in the first $45.00 of liquidating dividends paid by the corporation.[52] This waiver was required by the board, and executed by the recipients of the stock, in consideration of the fact that they had already received a cash distribution deemed to offset the amount which they would have received upon such stock had they not waived such dividend.[53]

None of the persons so receiving cash or stock was a member of the board of directors except the president, appellee W. R. Bassick, and he did not participate in any of the voting.[54]

On the same day, December 20, 1940, at a meeting of the stockholders of the corporation, it was elected that the corporation wind up its affairs and dissolve, and accordingly the dissolution of the corporation was commenced.[55]

On December 21, 1940, the board of directors, as voting trustees, determined that since the plant of the corporation had been sold, the corporation's creditors paid, and the purposes of the trust thus accomplished, it should and did terminate the voting trust[56] under which it held the 1907¾ shares of stock, beneficially owned by the old stockholders.[57]

---

[52]Tr. pp. 568, 819-821.
[53]Tr. p. 821.
[54]Tr. pp. 553, 564.
[55]Tr. p. 570.
[56]Tr. pp. 570-1.
[57]Originally 2212½ shares were so held, but the beneficial interest in 304¾ shares was surrendered to the corporation by one of its stockholders in satisfaction of the obligation of the stockholder to the corporation (Tr. p. 569).

On the same date, December 21, 1940, the board of directors declared a first liquidating dividend of $85,-848.75, or $45.00 per share, upon the 1907¾ shares so beneficially owned by the old stockholders—expressly providing that, pursuant to the waivers executed by the appellee managing officers now owning the remaining 2212½ shares, the dividend should not be paid upon the remainder of the outstanding shares.[58]

Thereafter, and on or about December 23, 1940, the corporation issued the new shares to which the old stockholders were entitled in exchange for their original stock, (the new shares being for 50% of their original holdings pursuant to the plan of reorganization), and thereafter delivered the exchange certificates to the old stockholders, together with a first cash liquidating dividend of $45.00 per share upon each of these shares.[59] Without objection, each of the appellants claimed and received the liquidating dividend upon his stock, amounting to $1,365.75 in the case of appellant Gladys M. Shores, and $28,001.25 in the case of appellant H. M. F. Behneman; a total of $29,367.00 to appellants upon the stock which was worthless at the time of reorganization.

A further liquidating dividend may be paid when the remaining non-operating property of the corporation is disposed of and outstanding taxes and expenses are satisfied. The amount of such a dividend is a matter of estimate at this time, but the testimony in this record is that in all probability it will not exceed $10.00 per share.[60]

---

[58]Tr. p. 571.
[59]Tr. pp. 571, 683-7.
[60]Tr. pp. 822, 632.

Development of the Consolidated Causes Now Before the Court.

On January 6, 1941, appellant Harold M. F. Behneman filed an action in the state court alleging, in essence, that the managing officers of the corporation had been paid their full compensation, that the affairs of the corporation had not been "rehabilitated" within the meaning of that term as used in the plan of reorganization and the order of the district court, and praying that the distribution of stock to the managing officers be declared illegal and void, that they be required to surrender said stock and have it cancelled, and that the directors be called upon to account for, and be enjoined against paying, any dividends thereon.[61]

On January 17, 1941, appellant Gladys M. Shores filed an almost identical action in the state court.[62] This action was duly removed to the district court,[63] and appellant Shores' motion to remand the same was denied.[64] Our comment upon appellants' complaint in this regard is reserved until later in this brief.

On February 19, 1941, the corporation and the other appellees filed their petition in the proceedings for the corporation's reorganization in the district court, setting forth most of the foregoing facts, and praying for an order effectuating and protecting the order of the district court confirming the plan of reorganization, and enjoining the threatened interference by the state court with said order and with the jurisdiction of the district court.[65]

---

[61]Tr. p. 338.
[62]Tr. p. 3.
[63]Tr. pp. 1-40.
[64]Tr. p. 47.
[65]Tr. p. 233.

This petition was referred to Honorable Burton J. Wyman, as special master, for hearing and report.[66]

On February 25, 1941, appellant Harold M. F. Behneman filed an action in the state court for supervision over the corporation's dissolution.[67]

On March 5, 1941, appellants filed a motion to stay the proceedings instituted by appellees' petition in the reorganization proceedings,[68] and this motion was referred by the district court to Honorable Burton J. Wyman, as special master, for hearing and report.[69]

On March 11, 1941, appellees filed a petition with the district court for an order restraining the state court actions pending the determination of the controversy;[70] and on the same day the court made its order staying said proceedings.[71]

On March 17, 1941, appellants filed a motion to dismiss appellees' petition and to terminate the stay of appellants' actions.[72] This motion, together with appellees' petition and appellants' motion to stay proceedings, came on for hearing before the Honorable Burton J. Wyman, special master, on March 18, 1941.[73]

On March 28, 1941, the special master filed his report and certificate with the district court, recommending that appellees' petitions be held properly filed and that appel-

---

[66]Tr. p. 281.
[67]Tr. p. 368.
[68]Tr. p. 284.
[69]Tr. p. 914.
[70]Tr. p. 286.
[71]Tr. p. 290.
[72]Tr. p. 336.
[73]Tr. p. 293.

lants' motion to stay proceedings and motion to dismiss petitions and injunction be denied.[74] Appellants filed objections to the report[75] and these objections came on for hearing before the district court, at which time ruling thereon was reserved. At the same time appellants and appellees stipulated in open court that appellants' removed "Shores case" be consolidated with appellees' petitions in the reorganization proceedings.[76] Pursuant to this stipulation, the district court ordered the consolidation.[77]

Accordingly, and after the filing of appropriate pleadings and interrogatories demanded by appellants, the causes so consolidated by stipulation of the parties came on for trial before the district court. That court rendered judgment in favor of appellees.[78]

Nature of the Consolidated Causes Now Before the Court.

It must be remembered that the bankruptcy reorganization proceeding now before the court is a proceeding *in rem,* and that the judgment and injunction of the district court were therefore rendered in the exercise of its *in rem* jurisdiction.

Appellants claim that the "Shores action" was "brought on behalf of the Hendy Co. and all of its stockholders against the individual appellees as the directors and managing officers of said company"[79] and argue that the "Shores action" affects "only the individual appel-

---

[74]Tr. pp. 293-371; particularly pp. 325-335.
[75]Tr. p. 371.
[76]Tr. pp. 916-917.
[77]Tr. p. 49.
[78]Tr. p. 131; Consolidated Findings and Conclusions, Tr. p. 98
[79]Appellants' Brief p. 26.

lees and not the rights of either the Hendy Co. or its creditors."[80]

This is obviously not true, for:

(1) There is no showing that the "Shores action" is representative of the desires of the other stockholders at all; on the contrary, it is clear that it is not;[81]

(2) The corporation is a vitally interested and necessary party. In the "Shores action" appellants sue not only the recipients of the distributions in question, but also the corporation and its directors who made such distributions. Appellants do not seek relief solely against the recipients of the distributions, but expressly attack the proceedings of the corporation and its board of directors taken pursuant to the plan of reorganization—and seek not only to have the rights of all parties under the plan of reorganization determined (and this necessarily includes creditors), but also to have the corporation's distributions declared illegal and void, the stock issued by it cancelled, the corporation's conduct with respect to all future dividends directed by the state court, and the corporation and its board of directors directed to account for, and be enjoined against paying, any dividends upon the stock distributed pursuant to the plan of reorganization. It clearly is incorrect to say that this is not a direct attack upon the action of the corporation and that the corporation is not vitally concerned with the nature and extent of the stock holdings in it, the reward of its

---

[80]Appellants' Brief p. 24.

[81]The largest creditor was also the second largest of the stockholders and the directors selected by and representing its interests, as well as the director selected by the stockholders, expressly voted for the distributions which appellants now attack.

management, the affairs of its creditors, the rehabilitation of its business, and whether or not it has properly executed the plan of reorganization as directed by the district court.

(3) And not only is the corporation vitally interested, but its creditors are similarly concerned. By the plan of reorganization the creditors scaled down their claims $76,401.00 and scaled down their interest rate upon the balance of their claims, so that their total contribution to the corporation amounted to approximately $100,000.00. This was done upon the condition, among others, that the stockholders contribute and give up 50% of their stock ownership. If appellants were successful in their "Shores action" they would completely nullify the plan of reorganization and this surrender of 50% of their ownership, and would, by cancellation of the stock issued to management, again own 100% of the outstanding stock of the corporation. The creditors are vitally concerned by such a maneuver, since, were it successful, the plan of reorganization would be so nullified that the creditors, with paramount rights, would be squeezed out of approximately $100,000.00, whereas the stockholders, wholly junior and subordinate, would have given up and lost nothing.

It is ridiculous to claim that the corporation and all parties interested in it are not vitally concerned in the "Shores action" and its attack upon the proceedings taken by the corporation pursuant to the plan of reorganization and the order of the district court.

ARGUMENT.

I.

THE DISTRICT COURT HAD JURISDICTION OVER THE SUBJECT MATTER OF THE CONSOLIDATED PROCEEDINGS.[82]

A. ANALYSIS OF APPELLANTS' ARGUMENT.

It is clear that there is complete factual identity between the subject matter (propriety of the distributions to the managing officers) of appellees' petitions in the district court and appellants' declaratory relief actions in the state court.[83] Indeed, we find nothing to the contrary in appellants' brief.

On the legal side, appellants' argument appears to shuttle back and forth between three main propositions: (1) The state court had **exclusive** jurisdiction of the subject matter; (2) The state court had at least **concurrent** jurisdiction of the subject matter; and (3) The federal court had **no** jurisdiction of the subject matter. Let us analyze each of these.

---

[82]Appellants' Brief pp. 23-37.

[83]Appellants argue (Appellants' Brief pp. 33-35) that the state court action brought under the provisions of Section 403 of the California Civil Code is distinguishable factually from the so-called declaratory relief actions and "can have no possible connection with the Hendy reorganization proceeding" (p. 35); and that the District Court erred in finding to the contrary, and was "without jurisdiction" (p. 35) to enjoin prosecution thereof.

Granting appellants' premise arguendo, the conclusion that any **jurisdictional** question is involved does not follow. And since appellants have not assigned or specified this portion of the injunctive relief granted as error except on jurisdictional grounds, we shall not consider it further. (See Appellants' Brief pp. 63-69; and Specifications of Error VII, VIII, pp. 20-21; where the contention is made that the injunctive relief granted goes beyond the scope of the issues, but no claim of error is made by appellants in regard to the enjoining of the aforesaid action.)

(1) Did the state court have exclusive jurisdiction?

Appellants do not seriously argue that any jurisdiction of the state court over the subject matter here involved was exclusive, except as that proposition might follow from the alleged lack of jurisdiction in the federal court. Appellants, without citation of authority, merely say (p. 27):

> "Jurisdiction over the parties to, and the subject matter of, these actions had already attached in the State Court at the time when their further prosecution was enjoined by said District Court. It is appellants' contention that * * * the State Court * * * had original and **exclusive** jurisdiction thereof."

The argument appears to be based upon the well-established rule that, where a state and federal court have concurrent jurisdiction over the same parties and the same subject matter, the tribunal where it first attaches retains it exclusively.[84]

---

[84]The rule and reason therefor are expressed in *In re Cohen* (1926), 198 Cal. 221, 244 Pac. 359, where the court quotes from *Ponzi v. Fessenden* (1922) 258 U. S. 254, as follows (198 Cal. 221, 226-227):

> " 'We live in the jurisdiction of two sovereignties, each having its own system of courts to declare and enforce its laws in common territory. It would be impossible for such courts to fulfill their respective functions without embarrassing conflict unless rules were adopted by them to avoid it . . .
>
> " 'The chief rule which preserves our two systems of courts from actual conflict of jurisdiction is that the court which first takes the subject-matter of the litigation into its control, whether this be person or property, must be permitted to **exhaust its remedy,** to attain which it assumed control, before the other court shall attempt to take it for its purpose . . .' "

See also:

Sutton v. English (1918) 246 U. S. 199;
Randall v. Howard (1862) 67 U. S. 585, 589;
Morrow v. Superior Court (1936) 9 Cal. App. (2d) 16, 22, 48 P.(2d) 188, 191;
7 *Cal. Jur.*, sec. 14, p. 691;
21 *C.J.S.*, sec. 529, p. 808.

But appellants have overlooked the fact that application of this principle to the case at bar compels the conclusion that jurisdiction was in the district court and **not** in the state court. The controlling factor is: which court first took the subject matter of the litigation into its control? And here it unquestionably was the district court which first took jurisdiction in the reorganization proceedings.

(2) Did the state court have at least concurrent jurisdiction with the federal court?

Appellants argue that the state court was not without jurisdiction over the subject matter of the declaratory relief actions, because:

(a) The plan of reorganization was "merely a contract between the debtor corporation, its creditors and stockholders" (p. 28); and "it certainly cannot be said that a State Court is without power to construe and interpret that contract" (p. 29);

(b) In any event, the order of confirmation is a judgment; a judgment creates a contract between the parties, so "an action on a judgment is an action on a contract;" and since "the interpretation and construction of contracts is within the province of a state court," the same must be true as to the interpretation and construction of judgments (p. 30).

These propositions are not determinative of the jurisdictional issue raised on this appeal. It is immaterial whether the state court had a sufficient jurisdiction to have enabled it to proceed with the declaratory relief actions had the district court not enjoined their prosecution. Appellants must establish, not merely that the

state court had jurisdiction, but that the district court did **not** have jurisdiction. To argue, as appellants do, that the state court might or must have had **concurrent** jurisdiction is to argue irrelevantly.

It is for this reason, too, that appellants' "case in point"[85] is completely beside the point. The case relied upon merely holds that where the subject matter of an action is within the jurisdiction of a particular court, that court is not ousted of its jurisdiction merely because the controversy may require it to construe a final instrument or document which was the result of action by another governmental tribunal or body. The facts of that case are in no way analogous to those involved here. But even if it were true, as appellants say (p. 32), that the "reasoning" of the cited decision "is applicable" here, this would go no farther than to support the proposition that the state court was not without jurisdiction—a proposition which appellees do not feel called upon to controvert, and which cannot assist appellants.

We must point out, however, that appellants' entire argument under this head is predicated upon a misconception of the nature of reorganization proceedings. The plan of reorganization under Section 77B of the Bankruptcy Act is not, as stated by appellants (p. 28), **merely** a contract between the debtor corporation, its creditors and stockholders. The plan is a proposal which must meet with requirements set forth in the statute and it is for the federal court to determine whether or not these requirements are met. If they are not met, as stated by Gerdes in the quotation appearing on page 28 of appel-

---

[85]*Henderson v. Oroville-Wyandotte Irrigation Dist.* (1929), 207 Cal. 215, 277 Pac. 487, cited in appellants' brief (pp. 31-32).

lants' brief, the court must dismiss the proceedings or direct that the debtor be liquidated.[86]

In *Case v. Los Angeles Lumber Co.* (1939) 308 U. S. 106, the supreme court referred to the all-inclusive jurisdiction of the court in reorganization proceedings and expressly held that an agreement as to the terms of a plan by the requisite majority of all parties in interest does not create a contract binding upon the court (308 U.S. at pp. 114, 125, 128-129):

> "At the outset it should be stated that where a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by § 77B(f) for confirmation of the plan has consented.
>
> * * * * * * *
>
> A debtor as well as a creditor who invokes the aid of the federal courts in reorganization or rehabilitation under § 77B assumes all of the consequences which flow from that jurisdiction. Once the property is in the hands of the court private rights as respect that *res* are subject to the superior dominion of the court and are to be adjudicated pursuant to the standards prescribed by the Congress. As a result of such proceedings the hand of all executions or levies may be stayed. **The court acquires 'exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section.'**
>
> * * * * * * *
>
> Thus respondent argues that since the plan of reorganization was entered into between the bond-

---

[86]See:

Gerdes on Corporate Reorganizations, Sec. 1036, pp. 1664-1665;

Remington on Bankruptcy, Vol. 10, Sec. 4608, p. 468; Sec. 4386, pp. 270-271.

holders and the stockholders before institution of the reorganization proceedings under § 77B, the consideration flowing from the stockholders had been furnished and the interests of the bondholders and stockholders in the assets of the debtor had been fixed prior to the filing of the petition. **In fact, respondent frankly insists that the stockholders' 'right of participation was secured by contract before, and as a condition precedent to, the institution of the 77B proceedings.'**

But the mere statement of this proposition is its own refutation. If the reorganization court were bound by such conventions of the parties, it would be effectively ousted of important duties which the Act places on it. Federal courts acting under § 77B would be required to place their imprimatur on plans of reorganization which disposed of the assets of a company not in accord with the standards of 'fair and equitable' but in compliance with agreements which the required percentages of security holders had previously made. Such procedure would deprive scattered and unorganized security holders of the protection which the Congress had provided them under § 77B. The scope of the duties and powers of the Court would be delimited by the bargain which reorganizers had been able to make with security holders before they asked the intercession of the court in effectuating their plan. Minorities would have their fate decided not by the court in application of the law of the land as prescribed in § 77B, but by the forces utilized by reorganizers in prescribing the conditions precedent on which the benefits of the statute could be obtained."

(3) Did the district court have jurisdiction?

a. Appellants argue that they "merely seek a determination of property rights arising out of the Plan"

(p. 28); and that the rights of the debtor and its creditors were not "affected" (p. 24).

At the same time, appellants concede (p. 28) that they attack and "question the right" of the debtor's directors "to distribute the Hendy stock in controversy" under the plan of reorganization. Appellants concede further (p. 33) that the federal court does have jurisdiction in cases where "an attempt was made to specifically do some act or thing which the court had previously decreed should not be done." But is not this precisely the case here? The question is: Did or did not the directors attempt to do an act (namely, make distributions to the management) which the district court had previously decreed should not be done, except under the circumstances specified in the decree? Hence by appellants' own test, the contention that this is a strictly private controversy is shown to be without merit.

Moreover, appellants are compelled to admit[88] that the gist of the controversy is the interpretation of the plan of reorganization itself. We shall point out presently that under the authorities such a controversy is within the jurisdiction of the district court wherein the

---

[88]Appellants say (p. 26) that the plan of reorganization "does not define what is meant by the term 'successful rehabilitation' ". "In the absence of a definition of this term in the Plan, **it becomes necessary to consider what all of the parties thereto, that is to say, the Hendy stockholders and creditors, intended it to mean when the plan was approved by them and confirmed by the district court.**"

Appellants say (p. 27) that the subject matter of these actions includes a determination of whether successful rehabilitation was accomplished "within the meaning of that term as used in the Hendy Plan"; and that "through these actions appellants question the interpretation" placed on the plan by the Hendy directors while the latter were proceeding to act under the plan.

plan of reorganization was formulated and whereby it was approved and confirmed.

To argue that no one is interested in or affected by this controversy except the management and the stockholders is to ignore the fact that appellants are really seeking to vitiate the plan of reorganization by squeezing some $100,000 out of the Hendy creditors, and profiting at the same time at the expense of those creditors and of the reorganization management by whose efforts alone appellants' equity as stockholders came into being.[89] It also ignores the fact that the purpose of reorganization proceedings is to promote a better realization of claims of creditors than would occur through immediate liquidation, with due regard to the superiority of such claims over the rights of stockholders.

In *In re Central Funding Corporation* (2nd C. C. A., 1935), 75 F. (2d) 256, Circuit Judge Augustus N. Hand said (p. 259):

> "A 'reorganization' does not necessarily presuppose the survival of the rights of stockholders or even of junior creditors, when they have become worthless, but may be a readjustment of the rights of lienors under a new corporate structure. * * * * * * * * * * *
>
> Thus a plan of reorganization may or may not provide for an issuance of new securities to stockholders. The plan here does not recognize an equity which is of no value, and it arranges simply for the carrying on of the same business * * * for a long enough period to enable the new corporation

[89]For a further discussion of this aspect, see our discussion of the nature of the consolidated causes before the court, supra pp. 24-26, and of the merits of the judgment, infra pp. 58-73.

to liquidate advantageously the collateral that secured the bonds that were issued by the debtor."[90]

The Supreme Court of the United States, as well as this Circuit Court of Appeals, has expressed in several decisions the fundamental principle that the interest of stockholders in the reorganized corporation is subordinate to the interest of creditors.[91]

b. Appellants argue that the district court was without jurisdiction because determination of the factual aspects of the controversy revolves about occurrences which took place *after* entry of the final decree (pp. 26-27),[92] and the decree contained no "reservation of jurisdiction" (pp. 36-37). We shall now point out that under the authorities these considerations are not controlling or even persuasive.

B. THE DISTRICT COURT HAD CONTINUING OR SUPPLEMENTAL JURISDICTION FOR THE PURPOSE OF ENFORCING OR EFFECTUATING THE FINAL DECREE CONFIRMING THE PLAN OF REORGANIZATION.

(1) The district court had ancillary jurisdiction to enforce its decree in the reorganization proceeding.

The basis of ancillary jurisdiction is well stated in *Venner v. Pennsylvania Steel Co.* (D. N. J. 1918) 250 Fed. 292, 296-297:

---

[90]See also:
Remington on Bankruptcy, Vol. 10, sec. 4386, p. 272.

[91]*Case v. Los Angeles Lumber Co.* (1939), 308 U.S. 106, 116, 120, 121-2, 126;
Securities and Exchange Commission v. U. S. Realty & Improvement Co. (1940), 310 U.S. 434, 452;
In re Consolidated Rock Products Co. (9th C.C.A., 1940), 114 F. (2d) 102, 106-117 (affirmed, 312 U.S. 510, 527).

[92]No authority is cited by appellants in support of this novel idea. It hardly needs to be said that ancillary proceedings frequently involve occurrences taking place after the entry of the original and otherwise final judgment.

"Is the supplemental bill ancillary in its character? A generalization of the cases * * * seemingly justifies the following, not as a precise classification, but an illustration of what constitutes ancillary jurisdiction in a federal court. It is a supplemental proceeding (a) to protect from interference with, and to determine, conflicting claims to assets, within its administrative control, and (b) to control and regulate suits brought before it and to restrain or enforce its judgments, or to further deal with the subject-matter thereof. Any proceeding having one or the other of these objects in view intervening in an existing action, whether by bill, petition, or motion, is dependent on the original suit, and the federal courts have cognizance thereof independent of any distinct ground of federal jurisdiction. Such jurisdiction may be invoked by a stranger to the original suit, and will not fail because new parties are brought in * * *"[93]

---

[93]Independent jurisdictional grounds are not required in ancillary proceedings.

Local Loan Co. v. Hunt (1934), 292 U.S. 234;
Campbell v. Golden Cycle Min. Co. (8th C.C.A. 1905), 141 Fed. 610;
1 Moore's Federal Practice, p. 466;
20 C.J.S. sec. 11, p. 330;
Gerdes on Corporate Reorganizations, sec. 1147, p. 1828.

In the *Campbell* case above cited Circuit Judge Sanborn said (p. 612):

"The suit in hand cannot stand as an original suit, because no federal question is involved in it and the requisite diversity of citizenship does not exist. But a suit in equity, dependent upon a former suit of which the federal court has jurisdiction, may be maintained in the absence of a federal question and of diversity of citizenship (1) to aid, enjoin, or regulate the original suit; (2) to restrain, avoid, explain, or enforce the judgment or decree therein; or (3) to enforce or obtain an adjudication of liens upon, or claims to, property in the custody of the court in the original suit. Such a suit is but the continuation in a court of equity of the original suit, to the end that more complete justice may be accomplished thereby."

From this and numerous like authorities it is clear, we submit, that the district court had ancillary jurisdiction to enforce its decree in the reorganization proceeding. And in this connection it should be emphasized that ancillary jurisdiction is exclusive, where the court's jurisdiction over the subject matter of the original proceedings was exclusive.[94]

(2) The district court sitting as a court of bankruptcy had jurisdiction to enforce its decree in the exercise of the plenary powers of a court of equity.

The determination of the extent of jurisdiction of the bankruptcy court involves a consideration of the powers of such a court. Section 77B (a) of the National Bankruptcy Act[95] provides in part:

> "If the petition or answer is so approved, an order of adjudication in bankruptcy shall not be entered and the court in which such order approving the petition or answer is entered shall, during the pendency of the proceedings under this section, have exclusive jurisdiction of the debtor and its property wherever located for the purposes of this section, and shall have and may exercise all the powers, not inconsistent with this section, which a Federal court would have had it appointed a receiver in equity of the property of the debtor by reason of its inability to pay its debts as they mature."[96]

The authorities are uniform to the effect that in exercising jurisdiction under the aforementioned section of the Bankruptcy Act, bankruptcy courts sit as courts

---

[94]21 C.J.S. sec. 88, p. 138.

[95]11 U.S.C.A. sec. 207(a).

[96]Substantially the same language is found in the new Chapter X of the Bankruptcy Act—sec 11 U.S.C.A. sec. 515.

of equity, and are governed by equitable principles, including the inherent power to protect their decrees by injunction or otherwise.[97]

The powers of a district court over a debtor in a reorganization proceeding are clearly stated in Gerdes on Corporate Reorganizations as follows (Vol. 1, sec. 459, pp. 698-700):

> "The federal district court, sitting as a court of bankruptcy, has original jurisdiction in all proceedings brought under Section 77B of the Bankruptcy Act. In such proceedings, the court has greater powers than those usually exercised in bankruptcy. * * *
>
> Every court of bankruptcy is also a court of equity, and the very purpose of the Bankruptcy Act is to establish and grant equity. If a bankruptcy court obtains jurisdiction of the person or of the subject matter, it may exercise the plenary powers of a court of equity for the ascertainment and enforcement of the rights and equities of the various parties. * * *
>
> In proceedings under Section 77B, therefore, the court has the following powers, derived from three sources: (1) the powers which a federal court has in an equity receivership, except such as are inconsistent with Section 77B; (2) the powers of a court in bankruptcy proceedings, except such as are inconsistent with the provisions of Section 77B; and (3) the powers given by Section 77B itself."[98]

---

[97] *Prudence Corp. v. Geist* (1942) 316 U.S. 89, 95;
Securities Comm'n v. U. S. Realty Co. (1939) 310 U.S. 434, 455, 457;
Pepper v. Litton (1939) 308 U.S. 303-304;
Clinton v. Shoop (8th C.C.A., 1941) 118 F. (2d) 811, 814;
In Re Charles Nelson Co. (N.D. Cal., 1939) 25 F. Supp. 56, 57.

[98] See also: Remington on Bankruptcy, Vol. 10, sec. 4402, p. 294.

Appellants contend that the final decree in the Hendy reorganization proceeding was "without any reservation of jurisdiction," and that, as a result, "the District Court lost all power to later entertain jurisdiction over injunction proceedings of the character instituted by appellees' petitions of February 19 and March 11, 1941."[99]

Contrary to this contention, we submit that the decree expressly reserves jurisdiction to deal with the identical matters here involved. (See the discussion of the form of decree at p. 45 infra.) But even if it were assumed that the decree did not expressly reserve jurisdiction, still, under settled principles governing the jurisdiction of the reorganization court, that court had continuing or supplemental jurisdiction over the proceedings instituted by appellees' petitions of February 19 and March 11, 1941. Many of the cases establishing this proposition are cited in Gerdes on Corporate Reorganizations in support of the following statement (Vol. 3, sec. 1147, p. 1828):

> "Although Section 77B states that the entry of the final decree closes the case, it is probable that the court will retain jurisdiction over all supplemental litigation which may arise out of the original proceeding. In equity receivership proceedings, the court may entertain such supplemental suits whether or not the ordinary jurisdictional requirements exist. In other words, such suits are subject to the court's jurisdiction whether or not there is diversity of citizenship, more than three thousand dollars in controversy, or a dispute involving federal questions."

Among the pertinent cases cited is *Minnesota Co. v. St. Paul Co.* (1864) 69 U.S. 609, where the court said (p. 632):

---

[99]Appellants' Brief, pp. 36-37.

"The present suit grows immediately out of and is a necessity which arises from the suit, by Bronson, Soutter, and Knapp, to foreclose the Land Grant mortgage; under the decree in which suit the Western Division of the La Crosse and Milwaukie Road was sold, and also all the rolling stock of the company belonging to both divisions, to the Milwaukie and St. Paul Railway Company. The present suit is really a continuation of that one. The rights of the parties depend upon the construction which is placed upon the acts of the court in it; and the present bill is necessary in order to have a declaration of what was intended by the orders and decrees made in that suit, and to enforce the rights which were established by it."[100]

A case presenting facts closely analogous to the instant case is *In Re Hermitage Bldg. Corporation* (7th C.C.A., 1938), 100 F. (2d) 597. In that case the debtor filed a petition for reorganization on September 18, 1934, and filed its proposed plan on December 12, 1934. The plan was confirmed on February 25, 1935. The plan included the following provision (p. 598):

"The common stock was to be held in the treasury of the corporation, and delivered to the holders of the old common stock at any time within five years from the effective date for the creation of the preferred stock, provided all the preferred stock should have been retired or redeemed."

---

[100]See also:

Cincinnati, etc. R.R. v. Indianap., etc. Ry. (1926) 270 U.S. 107, 114-117;

Riverdale Mills v. Manufacturing Co. (1904) 198 U.S. 188, 195;

Lang v. Choctaw, Oklahoma & Gulf R. Co. (8th C.C.A., 1908) 160 Fed. 355, 360;

Campbell v. Golden Cycle Min. Co. (8th C.C.A., 1905) 141 Fed. 610, 613;

St. Louis-San Francisco Ry. Co. v. M'Elvain (E.D. Mo., 1918) 253 Fed. 123, 128.

A final decree was entered on June 4, 1937, by the terms of which the plan was declared to have been carried out, the reorganization proceedings closed and terminated, and the debtor and its assets were released from the jurisdiction of the court. Thereafter, on January 11, 1938, appellant filed a stockholders' bill in an Illinois state court against directors of the debtor to compel the issuance of new common stock in accordance with the provisions of the reorganization plan, and for the restitution to the debtor of dividends alleged to have been illegally declared and paid in violation thereof. The state court directed appellant to present the matter of jurisdiction to the district court, which held that it had jurisdiction. In affirming the holding of that court the Circuit Court of Appeals said (pp. 599, 600):

> "It is first contended by appellant that the District Court was without jurisdiction to enter the injunction of March 30, 1938. There is no merit in this contention. Section 2(15) of the Bankruptcy Act, 11 U.S.C.A. § 11(15), authorizes the court to make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of the Act. While this provision has been construed to authorize the injunctive power of the court only where the one enjoined is interfering with property which is in the actual or constructive possession of the bankruptcy court, yet this limitation does not prevent that court from protecting and enforcing its own decrees, nor does it authorize a state court to review and alter the terms of the bankruptcy decree. * * * We think there can be no doubt that that court had jurisdiction of the subject matter, notwithstanding the fact that the final decree had dismissed the debtor and stated

that the plan had been carried out. * * * The plan was agreed upon and the reorganization of the debtor was perfected, but it was not completely executed, so as to determine the identity of the stockholders and their interests, nor could it be until it was determined whether the preferred stock would be redeemed or retired within five years. **Until that fact should be determined the bankruptcy court, under the facts here presented, had jurisdiction of the subject matter to protect and enforce its decree** (cases cited) * * *.

Furthermore, appellant's petition informs us that the plan was not carried out because, as he alleges, the new common stock was not issued by the debtor, and tendered to appellant for his endorsement in blank, as contemplated by the plan. If this be true, **it is obvious that the District Court had jurisdiction to see that the plan was complied with.**''

To the same effect see:

In Re 431 Oakdale Avenue Bldg. Corporation (N.D. Ill., 1939) 28 F. Supp. 63;

Hesselberg v. Aetna Life Ins. Co. (8th C.C.A., 1939) 102 F. (2d) 23, 27.

An additional ground upon which the bankruptcy court had jurisdiction over appellees' petitions of February 19 and March 11, 1941, is found in paragraph 15 of the final decree of January 27, 1937, which provides (Tr. p. 231):

''That all creditors of, claimants against, and stockholders of the debtor affected by said plan of reorganization, wheresoever situated or domiciled, be, and they are hereby, restrained and enjoined from pursuing or attempting to pursue or commencing any suits or other proceedings at law or in equity or

otherwise against debtor and/or said trustee, or any of the assets or properties of the debtor, directly or indirectly, on account of or based upon any right, claim, or interest which any such creditor, claimant, or stockholder may have had in, to, or against the debtor."

The temporary restraining order (Tr. pp. 290-293) and injunction (Tr. pp. 131-136) of the district court in the case at bar merely carry out the provisions of paragraph 15 of the original decree quoted above. Appellants violated paragraph 15 by commencing the actions in the state court and it was not only proper but necessary that the district court exercise its jurisdiction to enforce its decree.

See,

Holmes v. Rowe (9th C.C.A., 1938) 97 F. (2d) 537;
Local Loan Co. v. Hunt (1934) 292 U.S. 234;
In Re Hermitage Bldg. Corporation (7th C.C.A., 1938) 100 F. (2d) 597, quoted supra, pp. 40-42;
Cornue v. Ingersall (1st C.C.A. 1910) 176 Fed. 194.

In the *Holmes* case Circuit Judge Garrecht said (p. 539):

"A review of the decisions discloses that a Federal District Court, once having obtained jurisdiction of a controversy, and having rendered a decision in the matter, has complete power to protect the judgment or decree which it has rendered, and may go so far as to enjoin an action entertained in the state court by a litigant, involving the same subject-matter, when such action may in any way interfere with, or nullify the effect of said judicial determination. So here, the Court having discharged the appellee in bankruptcy, still retained sufficient jurisdiction to grant an injunc-

tion restraining appellant from levying execution upon a judgment rendered in his favor by the state court against the appellee upon a claim adjudicated in the bankruptcy court.''[101]

In the *Local Loan* case, the Supreme Court said (292 U.S. 239):

''That a federal court of equity has jurisdiction of a bill ancillary to an original case or proceeding in the same court, whether at law or in equity, to secure or preserve the fruits and advantages of a judgment or decree rendered therein, is well settled. [Cases cited.] And this, irrespective of whether the court would have jurisdiction if the proceeding were an original one.''

---

[101]This case was particularly relied upon by the special master. In his opinion he said (Tr. pp. 326-327):

''I. There is one proposition as to which I am absolutely certain, and that is that this court, inasmuch as 'the duties of the debtor and the rights and liabilities of creditors, *and of all persons with respect to the debtor and its property,* shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition or answer was approved,' has the jurisdictional power to deal with the matters referred to in the two petitions now before the court for consideration.

See Holmes v. Rowe, (C.C.A. 9) 97 F. (2d) 237.

In other words, it is my unqualified opinion that no successful contention can be made that this court by entering the final decree in the debtor proceeding here under consideration deprived itself of the right to defend said final decree, to say what it meant, or of the right to deny to any other court, except a Federal Appellate Court, the possibility of making a finding and decree which might put a different interpretation upon said final decree of this court from what would be found and decreed in said last mentioned court. In the language of In re Home Discount Co., 147 F. 552, 'The law does not make * * * weaklings of courts of bankruptcy. They have ample power to protect the bankrupt in the enjoyment of all his rights, and to frustrate the efforts of those who seek to defeat the practical enjoyment of them.' ''

(3) The district court had jurisdiction by virtue of the reservation of jurisdiction in the final decree confirming the plan of reorganization.

From the foregoing it appears that the district court would have jurisdiction of the instant proceedings even if appellants were correct in their contention that the "Final Decree" entered on January 27, 1937, did not reserve jurisdiction. However, contrary to appellants' contention, that decree expressly reserved jurisdiction to deal with the identical matters now before the court. It provided in part (Tr., pp. 231-232):

> "That the proceedings for the corporate reorganization of the debtor in this court entitled 'In the matter of The Joshua Hendy Iron Works, a corporation, debtor, No. 25937-S', be, and the same hereby are, terminated and closed; such termination and closing to be for all purposes final upon the filing herein of receipts showing the payment of the final fees and expenses hereinabove allowed, **and the surrender and exchange of the stock certificates which have not yet been surrendered and exchanged as provided in said plan of reorganization.**"

The order confirming the plan of reorganization and directing the reorganization of the debtor corporation also expressly reserves jurisdiction in the following language in paragraph 29 thereof (Tr., pp. 221-222):

> "That all matters not determined by this order are reserved by this court for future determination. That the life of this order shall be for and during such term as may be necessary to fully consummate the provisions of the aforesaid plan of reorganization. That this court further reserves the right and retains exclusive power and jurisdiction, by appropriate order or orders hereafter entered, to provide for and carry

> out said plan of reorganization under and subject to the supervision and control of this court, and hereby retains and shall have exclusive jurisdiction of the debtor and its property, wherever located, and shall have and may exercise all powers granted to it by law. * * *"

Section 6 (G) of the plan of reorganization (Tr., pp. 186-187), confirmed by the above mentioned order, requires the stockholders to endorse and deliver over the stock held by them to the board of directors of the debtor corporation, to be held by the board as follows: (1) 50% in trust for at least five years. Upon the expiration of this period and upon the payment in full of the extended obligations, these shares are to be returned to their respective owners. (2) The remaining 50% of the shares to be held by the board and to be distributed by the board in its sole discretion to the managing officers thereof as a reward for management and the successful rehabilitation of the company's affairs.

It is clear from the foregoing that the court intended and provided that the administration of the proceeding should not be closed until the surrender and exchange of the stock certificates in accordance with the confirmed plan of reorganization. The fact that on January 27, 1937, the court recited in its decree that the proceedings were at an end did not necessarily conclude the administration of the estate.[102] The provisions in the final decree for the surrender and exchange of the stock certificates constitute a clear reservation of jurisdiction for the pur-

---

[102]See, *In Re Paramount Publix Corporation* (2d C.C.A., 1936), 82 F. (2d) 230.

pose of effectuating the entire plan of reorganization. A part of this entire plan was the exchange of stock, which was accomplished long after the entry of the decree. That decree says that the surrender and exchange shall be made "as provided in said plan of reorganization." Until both the surrender and exchange is accomplished as set forth in the plan of reorganization, the district court retains jurisdiction. If this were not true, the above quoted language in the final decree would be meaningless.

Appellants' principal argument does not make against the jurisdiction of the district court, but on the contrary sustains this jurisdiction. Fundamentally, they argue that the stock has not been distributed in accordance with the plan of reorganization, and that the distribution of 50% of the stock to appellees Bassick, Hyland and Levit was unlawful. We contend and hereafter show (infra, pp. 58 to 73) that these arguments are without merit. But this aside, it is clear that if, as appellants contend, there has not been a distribution of the stock in accordance with the plan of reorganization, it must follow that the federal court has jurisdiction under the express reservation of jurisdiction in the decree until the stock is "**surrendered and exchanged as provided in the plan of reorganization.**" In other words, it necessarily follows, as practicably it should follow, that any attack upon the plan of reorganization or the manner in which it was carried out necessarily raises a controversy within the jurisdiction of the district court.

II.

REPLY TO APPELLANTS' CONTENTION THAT THE INDIVIDUAL APPELLEES ARE NOT PROPER PARTIES TO THE REORGANIZATION PROCEEDINGS.

Appellants say that the judgment should be reversed because (p. 41) "the individual appellees could not become proper parties to the Hendy reorganization proceeding by the mere act of filing their petitions" without following the intervention procedure outlined in Rule 24 of the Federal Rules of Civil Procedure.

This argument obviously relates to a mere technicality and does not affect the substantial rights of the parties. Nowhere do appellants suggest that, had a formal motion for permission to intervene been made, it would have been, or properly could have been, denied; nowhere do they suggest that they suffered any prejudice because of appellees' failure to file a formal motion in intervention.[103]

Appellees' original petition[104] fully stated the grounds and the facts upon which appellees sought relief. As to substance, therefore, it complied with the requirements specified for motion and pleading in intervention by Rule 24(c). The petition was referred to the special master with power to hear and determine all matters in con-

---

[103]28 U.S.C.A., sec. 391:
"On the hearing of any appeal * * * in any case * * * the court shall give judgment * * * without regard to technical errors, defects, or exceptions which do not affect the substantial rights of the parties."

[104]Tr. p. 233.

nection therewith.[105] As pointed out in appellants' brief, appellants appeared before the special master and specifically urged the point they now make (that appellees failed to file a formal motion for intervention). Subsequently they "again raised the same point * * * in the District Court" (Appellants' Brief, p. 41). It is clear, therefore, that the question of whether or not appellees had a right to intervene was directly presented and passed upon. Appellants say (p. 41) that the special master and the district court "ignored" their contention. On the contrary, we submit, the action of the special master and the district court is consistent with the granting of permission to intervene.[106]

Appellants argue that under the provisions of subdivision (c) (11) of Section 77B, appellees' right to intervene was merely permissive (p. 38, et seq.). It has been pointed out, however, that this section "can hardly be considered a restriction upon the ordinary rules of intervention."[107]

---

[105]The order of the district court referred the petition to the special master "with full and complete powers to hear said petition and all other matters in connection therewith, and to determine any and all questions and matters therein involved and herein, and to make appropriate orders and to do all things necessary or proper with reference to said petition and such questions and matters" (Tr. p. 281). The order fixed a time for hearing, and prescribed notice to appellants by service upon their attorneys (see Fed. Rules Civ. Proc., Rule 5 (b)). Such service was made and acknowledged (Tr. p. 284).

[106]"Overruling a motion to strike out a petition of intervention filed without leave of court has been held equivalent to granting leave, and to relate back to the date of the filing of such petition" (47 C.J. sec. 454, 233).

"As a general rule, leave to intervene is given by an order. Nevertheless, such leave may be implied" (10 Remington on Bankruptcy 546).

See, also, 39 Am. Jur. 946, n. 19.

[107]*Seaboard Terminals Corp. v. Western Maryland Ry. Co.* (4th C.C.A., 1940) 108 F. (2d) 911, 914.

And an interest based on property in the control of a court has traditionally been held to give an absolute right to intervene by analogy to the ancient equitable practice of examination *pro interesse suo.*[108]

In *Missouri-Kansas Pipe Line Co. v. United States* (1941), 312 U.S. 502, a suit in equity brought by the government to enforce the anti-trust laws, it was charged that the defendants had conspired to monopolize natural gas operations so as to shut out competition by the Panhandle Company. A consent decree was entered which sought to assure opportunities for competition by Panhandle. Panhandle attempted to intervene, but was denied permission. The supreme court pointed out that Panhandle's rights were safeguarded by explicit provisions in the decree—just as in the case at bar, the decree expressly recognized the interests of the management in the stock—and held that under these circumstances Panhandle unquestionably had standing to present its contentions to the trial court. In this connection, the court said (312 U.S. 508):

> "* * * the codification of general doctrines of intervention contained in Rule 24 (a) does not touch our problem. And since the protection afforded Panhandle by * * * the decree could only be secured by * * * active participation in the suit, the denial of that protection is a definitive adjudication, and so appealable."

Appellants suggest (p. 38) that formal intervention procedure was essential "in order to give the District

---

[108]Moore and Levi, *Federal Intervention*, 45 Yale Law Journal; Finletter, *Bankruptcy Reorganization*, pp. 594-599.

Finletter points out that the right to intervene may be absolute in reorganization proceedings, despite the apparently discretionary wording of the statute. He applies this to petitioners *pro interesse suo,* and particularly as to proceedings in rem.

Court jurisdiction of their petitions." This is unsound; no jurisdictional problem is presented here.

> *Levi and Moore, Federal Intervention,* 47 Yale Law Journal 898, 927:
>
> "* * * a rule which is in accordance with most of the cases * * * is that intervention under an absolute right or under a discretionary right in an *in rem* proceeding, need not be supported by grounds of jurisdiction independent of those supporting the original action. * * * the rule is in accordance with the general theory that in such situations intervention is ancillary to the main proceeding."

In addition to the foregoing, appellants' argument is wanting in substance for a further reason. Section 77B provides that "The debtor shall have the right to be heard on all questions." Appellants concede (p. 39) that the "right to be heard" is not "conditioned upon intervention."[109] Since the debtor was a party to the petitions filed here, the propriety of the procedure followed cannot be questioned. We have pointed out elsewhere the error of appellants' contention that the debtor was not an interested party to these proceedings (supra, pp. 24-26). But whether interested or not, it had a statutory right to be heard, and hence to file the petitions. The same

---

[109]There is a distinction between the "right to be heard" and "intervention."

Public Service Commission v. Philadelphia Rapid T. Co. (3d C.C.A., 1935) 82 F.(2d) 481;

Finletter, *Bankruptcy Reorganization,* pp. 592-3.

Indeed, that the right to be heard is not conditioned upon filing a petition for leave to intervene is entirely clear from the language of section 77B itself.

See also:

Rogers v. Consol. Rock Products Co. (9th C.C.A., 1940) 114 F.(2d) 108, 110.

reasoning applies to those petitioners who were directors of the debtor corporation.

Beyond this, all of the appellees—including those who appellants argue did not become parties to the reorganization proceedings—were joined as defendants in the Shores action which involves identical points and which, after removal to the federal court, was by stipulation of the parties consolidated with the reorganization proceedings (see p. 24, supra). A single judgment determining the rights of all parties was entered in the consolidated cause (Tr. pp. 131-136). Obviously, therefore, appellants' argument can not affect the substantial rights of the parties.

Finally, while formal intervention procedure as prescribed by Rule 24 might have been availed of by appellees, it was not essential. Ancillary jurisdiction may be invoked by bill or petition, as well as by motion.[110]

The original proceeding herein was one *in rem* under Section 77B. Appellees and petitioners were (a) the debtor; (b) the directors of the debtor who were charged by the plan of reorganization and final decree with certain duties as trustees in carrying out the plan of reorganization, some of which duties comprise the subject matter of the petitions; and (c) the managing officers of the debtor, whose interests in the stock distributed were provided for in the plan and in the decree of the court. All of these parties clearly had an interest sufficient to invoke the ancillary jurisdiction of the court by bill or petition.

---

[110] *Venner v. Pennsylvania Steel Co.* (D. N.J., 1918) 250 Fed. 292, 297.

III.

REPLY TO APPELLANTS' CONTENTION THAT THE DISTRICT COURT WAS WITHOUT JURISDICTION OF THE SHORES ACTION.

A. THE JURISDICTION OF THE DISTRICT COURT TO ENTER THE JUDGMENT UNDER REVIEW DOES NOT DEPEND UPON THE PROPRIETY OF THE REMOVAL OF THE SHORES ACTION.

In the succeeding subdivision of this brief we point out the reasons why the Shores action was properly removed to the district court. Here at the outset we wish to emphasize, however, that the jurisdiction of the district court does not depend upon the propriety of that removal. Since, as we have shown, the district court has jurisdiction to entertain appellees' petition in the reorganization proceedings, it had jurisdiction to render the judgment appealed from regardless of whether or not the Shores action was properly removed from the state court.[111] Hence, the validity of the judgment appealed from is not affected by the propriety of removal.

However, even if the question of removal were material, we submit that the Shores case was properly removed and that the district court correctly denied appellants' motion to remand.

B. THE SHORES ACTION WAS PROPERLY REMOVED BY THE DISTRICT COURT.

Appellants cite authorities which they contend support the absolute rule that a case arises under the laws of the United States, within the meaning of the removal statute

---

[111]We have already pointed out the identity of subject matter between the district court petitions and the state court suits. Supra, p. 27.

(28 U.S.C. 71), "only when a recovery depends on the construction of such a law", (Appellants' Brief pp. 45-46). We submit, for reasons hereinafter stated, that the Shores action necessarily involves the construction of the Bankruptcy Act. But this aside, the test stated by appellants is contrary to the terms of the removal statute itself and to the decisions construing that statute in situations similar to that presented in the case at bar. The rule applicable to this case is stated in section 184 of the Cyclopedia of Federal Procedure, immediately following that part of the text cited by appellants (Vol. 1, p. 854):

> "The plaintiff must claim and seek to vindicate in the action brought, a right or title under the Federal Constitution, laws or treaties, as distinguished from titles or rights depending on rules of the common law, or on state statutes or local laws and regulations."

As stated by the court in *Hartford Fire Ins. Co. v. Kansas City, M. & O. Ry. Co.* (N.D. Texas, 1918), 251 Fed. 332, 333:

> "It seems to me a suit arises under a law when it is brought to enforce the provisions of or liability thereby given, or is controlled as to the right of recovery by the provisions of such law."

To the same effect see:

American Surety Co. v. Shultz (2d C.C.A., 1915), 223 Fed. 280, 281;

Leslie v. Brown (6th C.C.A., 1898), 90 Fed. 171;

Rogge v. Michael Del Balso, Inc. (S.D.N.Y., 1936), 15 F. Supp. 499, 501;

M'Goon v. Northern Pac. Ry. Co. (N.D., 1913), 204 Fed. 998.

Familiar examples of the application of the foregoing principles are to be found in the cases holding that suits brought against federal corporations which owe their existence and derive all of their powers from federal statutes are suits arising under the laws of the United States within the meaning of the removal statute.[112] Other examples are suits brought for damages or injuries to property while being transported in interstate commerce;[113] suits to enforce the rights of an obligee against a bond taken by a federal court in conformity with a federal statute;[114] and actions in trespass against marshals of the United States for seizing property under attachment.[115]

In the case at bar the rights asserted by the parties in the Shores action are rights arising under a law of the United States, namely, the Bankruptcy Act. The original decree of the district court in the reorganization proceedings was not a decree adjudicating ordinary rights at common law, but a decree which confirmed to the parties, including the plaintiffs in the Shores action, rights given to them by the Bankruptcy Act. The alleged rights asserted by plaintiffs in the Shores action arise **exclusively** out of the provisions of the Bankruptcy Act. In this situa-

---

[112]*Federal Bank v. Mitchell* (1928), 277 U.S. 213;
Texas & Pacific Railway Co. v. Cox (1892), 145 U.S. 593;
Texas & Pacific Railway Company v. Kirk (1885), 115 U.S. 1.

[113]*Great Northern Ry. v. Galbreath Co.* (1926), 271 U.S. 99;
Southern Pacific Co. v. Stewart (1917), 245 U.S. 359.

[114]*Howard v. United States* (1902), 184 U.S. 676.

[115]*Bock v. Perkins* (1891), 139 U.S. 628, followed in an opinion by District Judge Van Fleet in *Frank v. Leopold & Feron Co.* (N.D. Cal., 1909), 169 Fed. 922; see also, *Allen v. Clark* (S.D. Cal., 1938), 22 F. Supp. 898.

tion a suit brought to enforce these rights, whether they be incorporated in a decree of a federal court or not, is one arising under the laws of the United States.

In *Woods v. Root* (7th C.C.A., 1903), 123 Fed. 402, an action was brought to enjoin officers of the United States from changing the location of a highway bridge over a government canal, in alleged violation of a decree of the district court. The bill was filed in a state court in Illinois and removed to the federal court upon the ground that it was a suit arising under the laws of the United States. The court said (p. 404):

> "The case was rightly removed into the United States Circuit Court. It arises out of an order made in the District Court in pursuance of an act of Congress authorizing the condemnation of the highway for the purpose of a canal. The suit is one, therefore, arising under the Constitution and laws of the United States.
>
> * * * * * * *
>
> To allow the bill under consideration to lie would be to charge the state court, or, on removal, the Circuit Court of the United States with the execution of the District Court's executory order. The two Courts might disagree as to the order's meaning, its scope, or the manner of its enforcement, and a conflict ensue such as the policy of the law forbids. Until the order is fully executed, so that it is no longer within the power of the court, but has become a fixed right of the party, no question going merely to its terms, or the manner of its enforcement, can be entertained outside the court that entered it. The Circuit Court of Whiteside County was in this respect without jurisdiction."

See also:

First Nat. Bank v. Society for Savings (4th C.C.A., 1897), 80 Fed. 581, 582, 583;

South Dakota C. Ry. Co. v. Continental & C. T. & S. Bank (8th C.C.A., 1919), 255 Fed. 941, 943.

Torquay Corporation v. Radio Corporation of America (S.D.N.Y., 1932) 2 F. Supp. 841.

This court had before it an analogous situation in *Pacific Telephone & Telegraph Co. v. Agnew* (9th C.C.A., 1925), 5 F.(2d) 221, where the state court had denied an application for removal in a suit involving the effect of the decree of a federal court. In its opinion this court expressed the view (5 F.(2d), at p. 223) that the state court erred in denying the petition for removal.

In addition to the foregoing we submit that the Shores action necessarily involved a construction of the Bankruptcy Act. Appellants say (Brief p. 48):

> "The Shores action merely involves a determination of the property rights of the parties thereto with respect to stock of the Hendy Co. in question, which rights were established by, and rise out of, the Hendy Plan of Reorganization and decree of the District Court confirming it. * * * Such determination may incidentally involve the interpretation and construction of the Hendy Plan * * *. But neither the Constitution nor laws of the United States can afford any aid in the solution of this problem."

This is incorrect. As heretofore pointed out, appellants seek a construction of the decree of the district court which would result in the stockholders of the reorganized corporation retaining 100% of their equity in that corpo-

ration while, at the same time, the creditors of the corporation would have given up substantial rights in their security interests and the reorganization management would not have been adequately compensated. If the decree of the court and the plan of reorganization were so interpreted, the plan clearly would be in conflict with the provisions of section 77B as construed by the Supreme Court of the United States. Therefore, it is evident that the plan of reorganization and the decree of the district court cannot be construed without considering the meaning and effect of the provisions of the Bankruptcy Act.

IV.

THE JUDGMENT OF THE DISTRICT COURT WAS PROPER "ON ITS MERITS".

We turn now to appellants' argument upon the merits. This point was originally abandoned. It was not specified as a ground of appeal and was raised only after appellants had been required to bring up a representative record.

Appellants state that:

> "Whether this stock distribution was proper is the fundamental question to be determined by this Court in deciding whether the judgment of the District Court was correct on the merits."[126]

This is **not** the fundamental question. The findings of the district court are presumptively correct and "are not to be disturbed on appeal unless they are clearly errone-

---

[126]Appellants' Brief p. 51.

ous'' (*Occidental Life Ins. Co. v. Thomas* (9th C.C.A., 1939), 107 F.(2d) 876, 878).[127]

The plan of reorganization provided that the board of directors should hold the 2212½ shares of stock ''free and clear of any claim, right, title, or interest therein'' by the old stockholders and distribute it

> ''in its sole discretion, either in whole or in part, to the managing officers thereof, as a reward for management and the successful rehabilitation of the company's affairs.''[128]

After approximately five years of capable management the board of directors determined that the affairs of the corporation had been successfully managed and rehabilitated and distributed the stock to the three managing officers of the corporation chiefly responsible therefor. This was done not only pursuant to the plan of reorganization, but also pursuant to repeated assurances to the managing officers in consideration of which these officers had been working for partial compensation.

A. APPELLANTS' ATTACK IGNORES THE EFFECT WHICH MUST BE GIVEN THE WORDS ''AS A REWARD FOR MANAGEMENT''.

Appellants first argue that since the managing officers were to receive the stock ''as a reward for management and the successful rehabilitation of the company's affairs'', the word ''and'' must be considered to have been

---

[127]See also:
Fed. Rules Civ. Proc., Rule 52 (a);
Cherry-Burrell Co. v. Thatcher (9th C.C.A., 1939), 107 F. (2d) 65, 69;
Bolander v. Godsil (9th C.C.A., 1940), 116 F. (2d) 437:
Luzier's, Inc. v. Nee (8th C.C.A., 1939), 106 F. (2d) 130, 135.

[128]Tr. p. 187.

used conjunctively and not disjunctively. They ignore the element of "reward for management" and also the uncontroverted testimony and findings that the stock, as well as the cash, was distributed to the managing officers partly as a reward for their successful management.

Appellants contend that the board of directors was empowered to distribute this stock **only** upon the successful rehabilitation of the company's affairs. This contention fails to give any effect to the provision in the plan, that the board, **in its sole discretion,** was entitled to give the stock to the managing officers "as a reward for management" as well as for "the successful rehabilitation of the company's affairs." Assuming for the purpose of argument that there is doubt whether the corporation was successfully rehabilitated—although the evidence plainly shows its rehabilitation—the language of the plan plainly entitles the directors to distribute the stock to the managing officers "as a reward for management." To determine otherwise would be to fail to give any effect to these words in the plan.

The meaning of the word "and" depends upon the intention of the parties demonstrated by the whole instrument. In numerous cases the word "and" has been construed as disjunctive in order to accomplish this intent.[129]

---

[129] *United States v. Fisk* (1865), 3 Wall. 445, 447;
Northern Commercial Co. v. United States (9th C.C.A., 1914), 217 Fed. 33, 36;
Manson v. Dayton (8th C.C.A., 1907), 153 Fed. 258, 269;
Brown v. Grand Rapids Parlor Furniture Co. (6th C.C.A., 1893), 58 Fed. 286, 291;
H. Laughlin E. Corp. v. J. W. Leavitt & Co. (1931), 116 Cal. App. 197, 201, 2 P.(2d) 511;
Abbey v. Board of Directors (1922), 58 Cal. App. 757, 760, 209 Pac. 709.

It is clear that the intention of the parties here demands a disjunctive construction. At the outset, when the plan of reorganization was being voted upon, appellants characterized the plan as giving the board of directors the power "to give [the stock] away at any stage that they want to,"[130] and that "there is no condition upon which these people are to get this stock, at what stage of the game."[131] All of the interested parties acquiesced in this statement and it was the plain intention of all. The special master epitomized the plain intent of the plan as follows:[132]

> "The Master. Why cannot the Court approve the use of it for the purpose of procuring a competent management and paying the managers, instead of the money, paying them by delivering stock to them?"

Appellants cannot deny that the stock did "reward management," and this is a complete answer to the contention that the stock was not properly distributed. The words "as a reward for management" were intended to be given effect—otherwise they would not have been used. Thus it is clear that the word "and" was used disjunctively, and that the stock was properly used for the reward of management.

B. APPELLANTS' ATTACK IGNORES THE PLAIN MEANING OF THE PLAN WITH RESPECT TO "SUCCESSFUL REHABILITATION".

But to go further. Let us assume, for the purpose of argument only, that appellants' contention is correct and that the distribution of the stock should have been judged

---

[130]Tr. pp. 452; 698.
[131]Tr. pp. 459; 699.
[132]Tr. pp. 460; 700.

solely by the fact of "successful rehabilitation." Appellants make two arguments in this connection:

(1) That the determination of the fact of "successful rehabilitation" was not in the discretion of the board of directors;[133] or

(2) If it was, then the board's determination of that fact was a "gross abuse of discretion."[134]

(1) The board of directors had discretion to determine whether the corporation's affairs were successfully rehabilitated.

With respect to appellants' contention that the board of directors had no discretion to determine whether or not the company had been successfully rehabilitated, it is sufficient to refer to the understanding of the parties when the plan of reorganization was under consideration and adopted. Appellants then stated that under the terms of the plan of reorganization the board of directors had **complete discretion** as to when the stock should be distributed. **This construction was acquiesced in by all of the parties participating in the deliberations.** The intention of the parties and the court when the plan was adopted and approved is the controlling intention, and that intention was clear. Appellants stated with respect to the provisions of the plan regarding the stock to be held by the board of directors for distribution:[135]

"Furthermore, they say to give it to the Board of Directors **to give away as they please** for the successful rehabilitation of the company's affairs. All right, what does that mean? I asked Mr. Pedder, who is attorney here, I said 'Does that mean when it is on

---

[133]Appellants' Brief p. 54.
[134]Appellants' Brief p. 55.
[135]Tr. pp. 452; 698.

a dividend paying basis? Does that mean when the debts are paid? Is that a condition?' He said 'Oh no, **that is to give away at any stage that they want to.**' * * *''

Appellants further stated:[136]

"You do not modify the right of stockholders by taking out of their pockets and putting into the pockets of anybody else. Furthermore, **there is no condition upon which these people are to get this stock, at what stage of the game.**''

Again, in the proceedings before the special master the following discussion was had:[137]

"The Master. In a matter of this kind has the Bankruptcy Court authority in response to a plan of this kind that is consented to by a sufficient number of stockholders, to wipe out some of the stock? I am speaking of common stock certificates. We have the right to do that.

Mr. Byrne [one of appellants' attorneys]: To make them surrender?

The Master. Yes cancel it.

Mr. Byrne. I am rather inclined to think it could be cancelled.

The Master. Why cannot the Court approve the use of it for the purpose of securing a competent management and paying the managers—instead of the money paying them by delivering stock to them?''

And, in the certificate and report of the successor special master, the effect and intent of the plan was thus expressed, at the end of the master's opinion and report:[138]

---

[136]Tr. pp. 459; 699.
[137]Tr. pp. 460; 700.
[138]Tr. pp. 165-166; 702.

"The herein proposed plan in effect says to the stockholders, 'Your stock at the present time is worthless; this you concede when you admit the corporation is insolvent. Turn in all your stock. If at the end of five years the payment in full of the extended obligations has been accomplished, fifty per cent (50%) of that stock will be returned to you, the other fifty per cent (50%) is to be held free and clear of any claim, right, title or interest of yours. This latter portion of your stock, in its sole discretion, the Board of Directors will distribute, either in whole or in part, to the managing officers thereof as a reward for management and the successful rehabilitation of the company's affairs.' Bluntly put the proposition to the stockholders is this: You have nothing now except some worthless stock. Surrender it. Perhaps at the end of five years, if things go as planned, you will get back one-half thereof and it may be of some value. It also may be that the other half of your stock, at that time may be of like value, but in the meantime has been placed in hands other than yours for a consideration, however.

Such being the case, there is nothing strange or inequitable about such a set-up; it is not a case of taking from Peter to pay Paul. All it amounts to is a practical way of putting into effect the ancient maxim '* * * the labourer is worthy of his hire.' "

This report and conclusion was adopted and confirmed by the district court in its order confirming the plan of reorganization.[139]

---

[139]And this same intention and construction is manifested in the written arguments of appellants' counsel and others with respect to the plan. Tr. pp. 883-912, particularly Tr. pp. 889, 908-909.

Thus it was fully understood by all parties that the directors should have complete discretion and could distribute the stock "at any stage that they wanted to." After all, the plan of reorganization provides that the distribution by the board shall be "in its sole discretion" and we submit that that means what it says, and is not limited to a mere determination of the amount of stock that should be distributed, as appellants **now** contend, without any discretion as to whether management was being rewarded or the company's affairs had been successfully rehabilitated.

(2) The corporation's affairs were, in fact, "successfully rehabilitated;" and the corporation's board of directors properly so found.

But, say appellants, if this be true then the board of directors was, in view of the facts, guilty of a "gross abuse of discretion" in determining that the affairs of the company were successfully rehabilitated.[140] And what is appellants' justification for this contention? Merely their uncorroborated and unusual theory that it was the intent of the plan of reorganization to insure the continued life of the corporation as a going business for the benefit of the existing stockholders (who then had no equity),[141] and their further theory, equally indefensible, that under the terms of the plan of reorganization the company could not be said to be "successfully rehabilitated" until **all** of the obligations covered by the plan—$569,969.72 in principal amount, plus the interest thereon—had been paid in full out of **earnings** of the corporation

---

[140] Appellants' Brief p. 55.
[141] Appellants' Brief p. 57.

derived from the operation of its business as a going concern.[142] These theories simply invite this court to substitute appellants' tortured definition of the term "successful rehabilitation" for the definition given to that term by the district court which was familiar with all the facts surrounding its use in its own plan and decree, and to substitute its determination of facts for the facts found from the evidence by the district court.

When the plan of reorganization was adopted the company was insolvent—according to appellants' own attorneys, "absolutely busted."[143] The stockholders, including appellants, had no interests to be preserved or protected. The creditors determined to keep the corporation going. The reason for the continuance of the corporation's business was the usual reason—as the trustee advised the chief creditor:[144]

> "* * * he thought a better liquidation could be accomplished if the business could be continued to operate for a trial period of a year or two, he thought that there was a possibility that it did have a going concern value, and if it did and there was an opportunity to sell it, that could be presented to the court."

To say that the corporation was not solvent and its affairs "rehabilitated" until it had paid out of earnings every penny of its $569,969.72 of receivership obligations, plus interest, is neither good business nor good sense. If that were the test of "rehabilitation" or solvency then

---

[142]Appellants' Brief p. 6.
[143]Tr. pp. 462; 159; 696-697.
[144]Tr. p. 742.

there is hardly a corporation existing today which could qualify, since virtually all have outstanding obligations.

Nor are the definitions of "rehabilitation" cited by appellants consistent with their contention.[145] The definition from *Webster's New International Dictionary, Second Edition, Unabridged,* certainly does not support appellants' contention since it defines rehabilitation as being merely a restoration to a former state of "**solvency**, efficiency, or the like." As we shall show, the corporation had a net worth at the time of the distribution of stock of $335,825.33, and was thus plainly solvent. The case of *New York Title & Mortgage Co. v. Friedman,* cited by appellants, with emphasis, is not apposite because that case involved the definition of "rehabilitation" as that term is specially used in the New York Insurance Law, and in *In re Title & Mortgage Guarantee Co.* (1934), 274 N.Y.S. 270, it was shown that such definition was peculiar under the New York law. And in any event, both of these cases hold only that rehabilitation is in essence restoration to **solvency**.

The case of *In re Coleman,* cited by appellants, arose under Section 75 of the Bankruptcy Act. In another case construing this same section appellants' contention was expressly repudiated, and the court held that rehabilitation under the Bankruptcy Act does not necessarily mean payment of debts in full. *In re Anderson,* 22 F. Supp. 928, at 932, the court stated:

> "**To rehabilitate does not necessarily imply an ability to pay in full one's entire debt structure** * * * The farmer is in bankruptcy and the liens are worth

[145] Appellants' Brief pp. 61-62.

> no more than the value of the property to which they apply. Therefore, in interpreting the act one should not conclude that the farmer must be able to demonstrate to a certainty his ability to pay the liens in full during the three-year period in order to obtain the stay of proceedings.''

It is plain that the affairs of the corporation were rehabilitated at the time the stock was distributed by the board of directors. Indeed, the corporation was successfully rehabilitated well before the sale of its Sunnyvale plant; it was solvent and its stock had a real substantial value as early as 1939.[147]

There is no conflict in the evidence in this regard. In major outline the evidence shows that:

(1) Whereas the company had a net worth of *minus* $61,787.36 at the time the plan was adopted, it had a net worth of $142,862.27 at the end of 1939, of $206,330.87 before the sale of its plant in 1940, and of $335,825.33 following the sale and at the time that the stock was distributed;[148]

(2) Whereas during the twenty months prior to reorganization the company had lost some $183,000.00,[149] it had under the reorganization management a net income of more than $229,730.73.[150] And what is more, prior to reorganization no adequate reserves for depreciation, etc., had been taken,[151] whereas the

---

[147]Tr. pp. 838; 709.
[148]Resp. Ex. Nos. H, F.; Tr. pp. 801-806; 849.
[149]Resp. Ex. No. B; Plff. Ex. No. 3A.
[150]Resp. Ex. Nos. H, F; Tr. pp. 801-6, 849.
[151]Tr. pp. 869; 435-7; 798-801.

net income figures following reorganization are taken only after full deductions for depreciation and interest;[152]

(3) Whereas the company had, immediately following reorganization, outstanding obligations of $569,969.72, the corporation had by the time of sale, under its reorganization management, paid off more than 50%, or more than $300,000.00 upon its said debts, over and above all operating charges, including proper depreciation;[153] and had adequate current assets to meet the balance.[154] Appellants' attempted point that these current assets were not all in cash until after the sale is meaningless;

(4) Whereas the physical plant and properties of the corporation were, at the time of reorganization, in a "deplorable condition", they had, by the time that the stock was distributed, been brought back by the reorganization management, out of operating revenues, to a state of normal operating efficiency;[155] and

(5) Whereas the corporation was at the time of reorganization disorganized and of no particular value as going concern, it had by the time that the stock was distributed, been "brought back" by the reorganization management to a point where the corporation had value as a going concern, and was attractive

---

[152]Resp. Ex. Nos. H, F. Tr. pp. 801-806, 849.
[153]Resp. Ex. Nos. I, G; Tr. pp. 805-808, 849.
[154]Resp. Ex. No. C; Plff. Ex. No. 3 F.
[155]Tr. p. 725.

> enough to interest an outside purchaser willing to purchase it at a profit to the corporation of some $131,000.00.[156]

In other words, the corporation which was insolvent and "absolutely busted" at the time of reorganization had, by the efforts of the reorganization management, been brought back and rehabilitated to a point where it was solvent to the extent of several hundred thousand dollars; and its stock which was worthless at the time of reorganization had acquired a substantial value. This is the plainest possible showing that the company was restored to solvency and as a going concern and had acquired a real net worth, and hence the plainest possible showing that it had been successfully rehabilitated.

After all, the directors of the company were the persons most familiar with its affairs. Not only is there a normal presumption as to the propriety of their action, but the evidence so wholeheartedly supported their action that there was no reason for the district court to substitute its judgment, and on the facts it could only concur with the judgment of the board of directors. The evidence of this restoration to solvency by the reorganization management of the corporation is uncontradicted.

Appellants' only attempted answer is a veiled criticism of the sale of the Sunnyvale plant by the corporation. Yet there is not the slightest suggestion by appellants that the sale was not properly made and that it was not advantageous to the corporation in that it resulted in a profit

---

[156]Tr. p. 860; Resp. Ex. No. F.

of some $131,000.00 to the corporation. The sale was not attacked in the pleadings; was not an issue; and was not attacked by evidence adduced at the trial.

C. A WORD AS TO THE EQUITIES.

As we have heretofore pointed out, the purpose of reorganization under Section 77B of the Bankruptcy Act has repeatedly been held to be the promotion of a better realization of the claims of creditors than would occur through immediate liquidation, with due regard to the superiority of such claims over the rights, if any, of stockholders. In this case, since the corporation was confessedly insolvent at the time of reorganization, the old stockholders had no rights to be protected, and anything that they got out of the reorganization was a sheer "windfall" to them.

Here the reorganization management was so successful that not only were the creditors of the insolvent corporation paid their scaled-down claims in full—and this could not have been done at the time of reorganization—but the old stockholders, whose stock was worthless, have received $45.00 a share upon their stock, with the prospect of receiving a still further final liquidating dividend.

The old stockholders would not have received this large liquidating dividend had it not been for the fact that in the plan of reorganization the creditors voluntarily scaled down their claims against the corporation by $76,401.00, and further scaled down the interest thereon—and these are the same creditors whom appellants now condemn for their action in compensating the management for making payment to the creditors and stockholders possible.

In addition, both of the appellants have accepted all of the benefits of the plan of reorganization, the benefits of the decree of the district court confirming it, and the benefits of the successful reorganization management pursuant thereto. Neither of appellants objected to the sale of the corporation's plant at a profit of $131,000.00, and both of the appellants promptly collected their $29,367.00 share of the first liquidating dividend. Having accepted these benefits of the plan and its operation, appellants are estopped to deny and should be compelled to submit to its conditions and the conditions of the decree enforcing it.

Smith v. Missouri Pac. R. Co. (8th C.C.A., 1920), 266 Fed. 653.

In that case the court said, page 657:

> "As the appellant claims to have a right of action against the appellee by virtue of the foreclosure decree solely, she cannot accept the benefits of that decree, without submitting to the conditions, upon which this privilege is granted, the right of the court, which rendered the decree, to determine the liability of the receiver, to the exclusion of every other tribunal."

D. APPELLANTS REALLY ASK THIS COURT TO ABROGATE THE TERMS OF THE PLAN OF REORGANIZATION UNDER WHICH ALL PARTIES HAVE ACTED.

What do appellants really seek? They seek the complete nullification of the plan of reorganization. Under the plan of reorganization the creditors gave up approximately $76,401.00 of bona fide claims against the corporation and scaled down the interest upon the balance of their claims upon condition that the stockholders should give up and contribute 50% of their ownership and stock and upon the

further express condition that provision should be made for the compensation of a competent management. If appellants are now given what they seek—the cancellation of that 50% so given up—the old stockholders will then again own 100% of the outstanding stock of the corporation; will have squeezed approximately $100,000.00 in principal and interest out of their creditors in the process; will have deprived the management of compensation agreed upon and earned; and will have completely nullified and abrogated the plan of reorganization. In other words, the old stockholders, whose stock was junior and worthless, will have everything they ever had, and more—at the expense of the creditors and the reorganization management who gave the stock every particle of value it acquired and has. This, we submit, is not only unsupported by the evidence and the plan of reorganization but is inequitable in the extreme.

We submit that there is no uncertainty in the paragraph regarding the distribution of stock to management, and that the board of directors properly distributed the stock. If, however, it might be said that there is any ambiguity in this regard, then we submit that the proper court to clarify such uncertainty and define "successful rehabilitation" was the district court which was familiar with all the facts surrounding the use of that term in its plan of reorganization and decree. In view of the abundant evidence supporting its judgment, we submit that the district court's determination is proper and conclusive.

V.

THE INJUNCTIVE RELIEF GRANTED BY THE DISTRICT COURT IS RESPONSIVE TO THE ISSUES.

Appellants complain that the issues raised in the consolidated pleadings were so limited that the district court could only deal with and enjoin actions relating to the distribution of stock to the corporation's managing officers, and that appellants should now be free to prosecute actions in the state court "involving the propriety of bonus and cash payments" to said officers. There is no merit in this contention.

A. THE DISTRICT COURT'S INJUNCTION IS RESPONSIVE TO THE ISSUES RAISED BY THE PLEADINGS.

(1) Under the pleadings, all of the compensation of the corporation's officers, both stock and cash, was in issue.

It is not true, as appellants say, that the consolidated causes "deal solely and exclusively with the propriety of the distribution to appellees Bassick, Hyland, and Levit * * * of 2212-½ shares of Hendy stock."[157] On the contrary, all of appellees' compensation, whether by way of stock or cash distribution, was in issue.

The complaint of appellant Shores expressly alleges that:

> "From on or about March 26, 1936, and continuously thereafter up to on or about November 15, 1940, the above named defendants Bassick, Hyland, Levit, First Doe, Second Doe, and Third Doe were employees of Hendy Co., and as such were, during said period, **fully compensated for services rendered to said corporation;** * * *"[158]

---

[157] Appellants' Brief p. 63.

[158] Tr. p. 4.

This allegation was put in issue by appellees' denial.[159]

Similarly, in the other of the consolidated causes, the reorganization proceedings, appellees' petition pleads that the compensation of appellees Bassick, Hyland, and Levit was only partial, and was supplemented by the subsequent distributions referred to in the evidence.[160] These allegations were put in issue by appellants' denial.[161]

(2) Proof and judgment with respect to cash distributions were necessary to the court's determination of the propriety of the stock distribution.

Moreover, before the district court could determine whether the stock was properly distributed to the managing officers, it had first to determine what cash distributions had been made. The propriety of the "reward to management" by cash was thus an integral part of the court's determination of the propriety of the stock distribution. Indeed, both appellants and appellees introduced studies purporting to showing the cumulative result of both cash and stock distributions—considered together and as an integrated reward to management.[162]

B. EVEN WERE THE DISTRICT COURT'S INJUNCTION NOT RESPONSIVE TO THE ISSUES RAISED BY THE PLEADINGS, IT IS NEVERTHELESS RESPONSIVE TO ISSUES RAISED DURING THE COURSE OF TRIAL.

Even assuming that the question of cash distributions was not raised by the pleadings—which it plainly is—it is clear that the question of the cash distributions was expressly raised by appellants during the trial, and, thus,

---

[159]Tr. p. 52.
[160]Tr. pp. 238-244.
[161]Tr. pp. 376-378.
[162]Resp. Ex. No. J; Plff. Ex. No. 5.

upon an entirely separate ground, the determination and judgment of the court with respect thereto was proper. Appellants opened up the question of the salaries, bonuses, and cash paid by the corporation to its managing officers. These matters were exhaustively gone into in appellants' interrogatories and appellees' answers thereto. These were read into evidence by appellants.[163] Appellants' attorneys repeatedly referred to the cash distributions in their opening statement, and offered and elicited evidence in this regard. It is true that at the outset appellees' attorneys objected to such evidence, but the objection was overruled,[164] and thereafter, without objection, appellants developed, by stipulation[165] and otherwise, all of the salaries, bonuses, and cash distributions made to the managing officers.

Appellants now say that these facts were brought out only "for the *limited purpose* of showing that in December of 1940 the Hendy Co. could only have made cash disbursements * * * by resorting to the proceeds of sale of the capital assets of the Company."[166] But there is nowhere in the record any indication of this limited purpose. Without any limitation, appellants read in the answers to the interrogatories with respect to the cash distributions,[167] stipulated the amounts thereof,[168] interrogated the managing officers with respect thereto,[169] offered no objection to cross-examination and further inquiry along

---

[163]Tr. pp. 553-556; 62-64; 75-89.
[164]Tr. pp. 550-553.
[165]Tr. pp. 557-563.
[166]Appellants' Brief p. 68.
[167]Tr. pp. 553-556.
[168]Tr. pp. 557-563.
[169]Tr. pp. 557-563.

the same line,[170] introduced in evidence and based accounting testimony on the annual reports of the company setting forth the details regarding such cash distributions,[171] and introduced exhibits calculating the net effect of such cash distributions considered together with the stock distributions.[172]

Thus, apart from the fact that the relief granted by the district court was responsive to the issues raised by the pleadings, the injunction was clearly responsive to the issues framed by appellants during the trial. The decree, therefore, was proper.[173]

The scope of the issues is not to be judged solely by the "Shores" complaint. Injunctive relief was, after all, granted in response to appellees' petitions,[174] which pleaded the inadequacy of the compensation of the corporation's managing officers and prayed generally and specially for protection of the corporation's actions in carrying out the plan of reorganization.

---

[170]Tr. pp. 578-579, 581-583, 627-630, 728, 733-735, 826, 833-835.

[171]Tr. pp. 709-710, 712, 817-825, 705.

[172]Plff. Ex. Nos. 3, 3A, 3B, 3C, 3D, 3E, and 3F; Tr. pp. 634-649.

[173]*Schmidt v. United States* (8th C.C.A. 1933), 63 F. (2d) 390, 392;
Stewart v. Crowley (1931), 213 Cal. 694, 699-700; 3 P.(2d) 562;
Starkweather v. Eddy (1927), 87 Cal. App. 92, 98; 261 P. 763.

[174]Tr. pp. 233-249.

CONCLUSION.

We submit that the district court was clearly the proper tribunal, both in law and in logic, to interpret, effectuate, and protect its own decree and plan of reorganization; and that its judgment is supported by the evidence. The judgment is particularly compelling in this case because it was rendered by the same judge, Honorable A. F. St. Sure, before whom the reorganization proceedings were had, and by whom the decree and plan in question were made. The judgment should be affirmed.

Dated, San Francisco, California,
September 28, 1942.

Respectfully submitted,

MARSHALL P. MADISON,
FRANCIS R. KIRKHAM,
GERALD S. LEVIN,
STANLEY PEDDER,
KENNETH FERGUSON,
PERCY V. LONG,
BERT W. LEVIT,
WILLIAM H. LEVIT,
Attorneys for Appellees.

PILLSBURY, MADISON & SUTRO,
LONG & LEVIT,
Of Counsel.